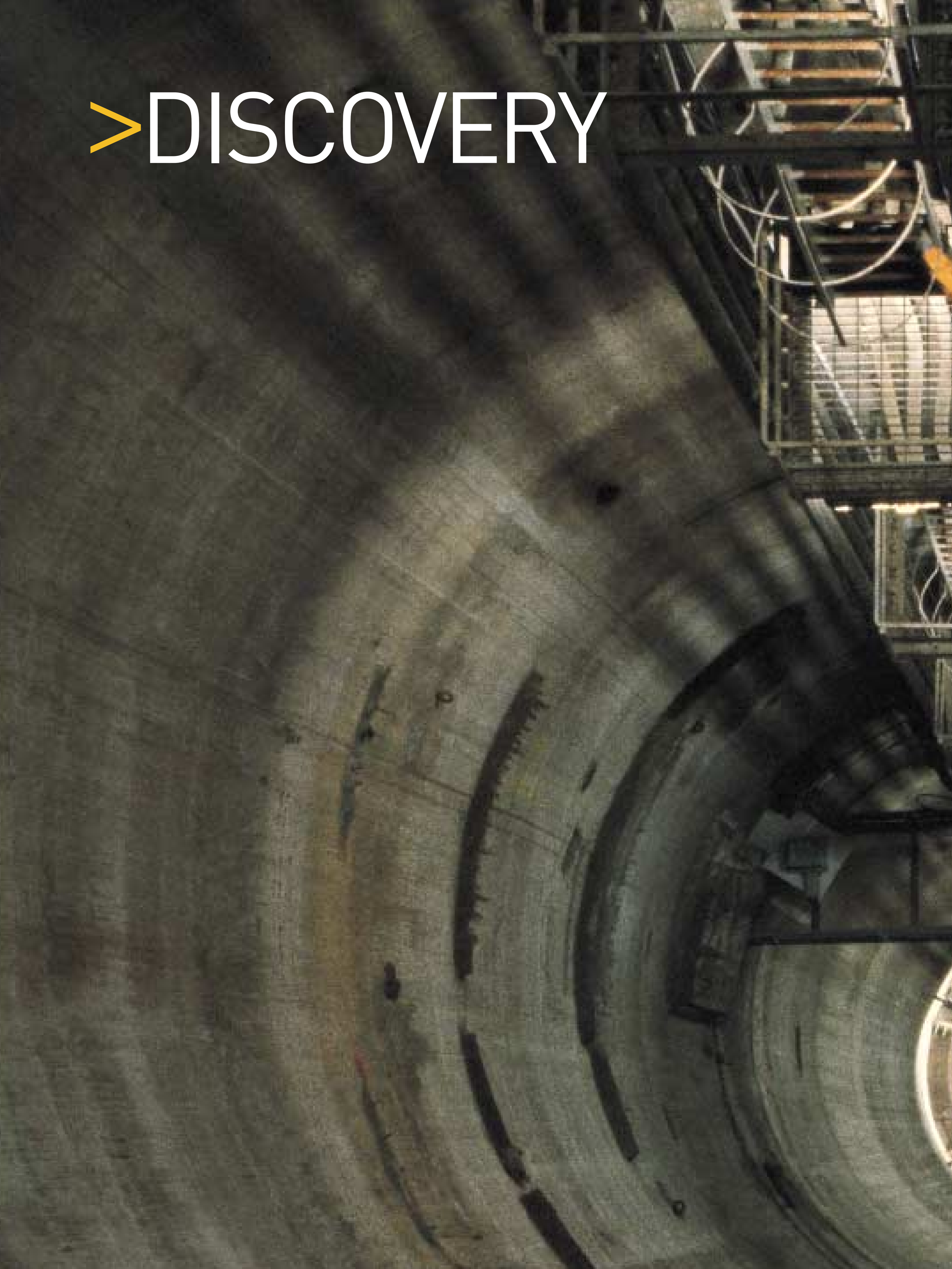
>FORWARD
Annual report and accounts 2001

smiths

>EQUIPPED

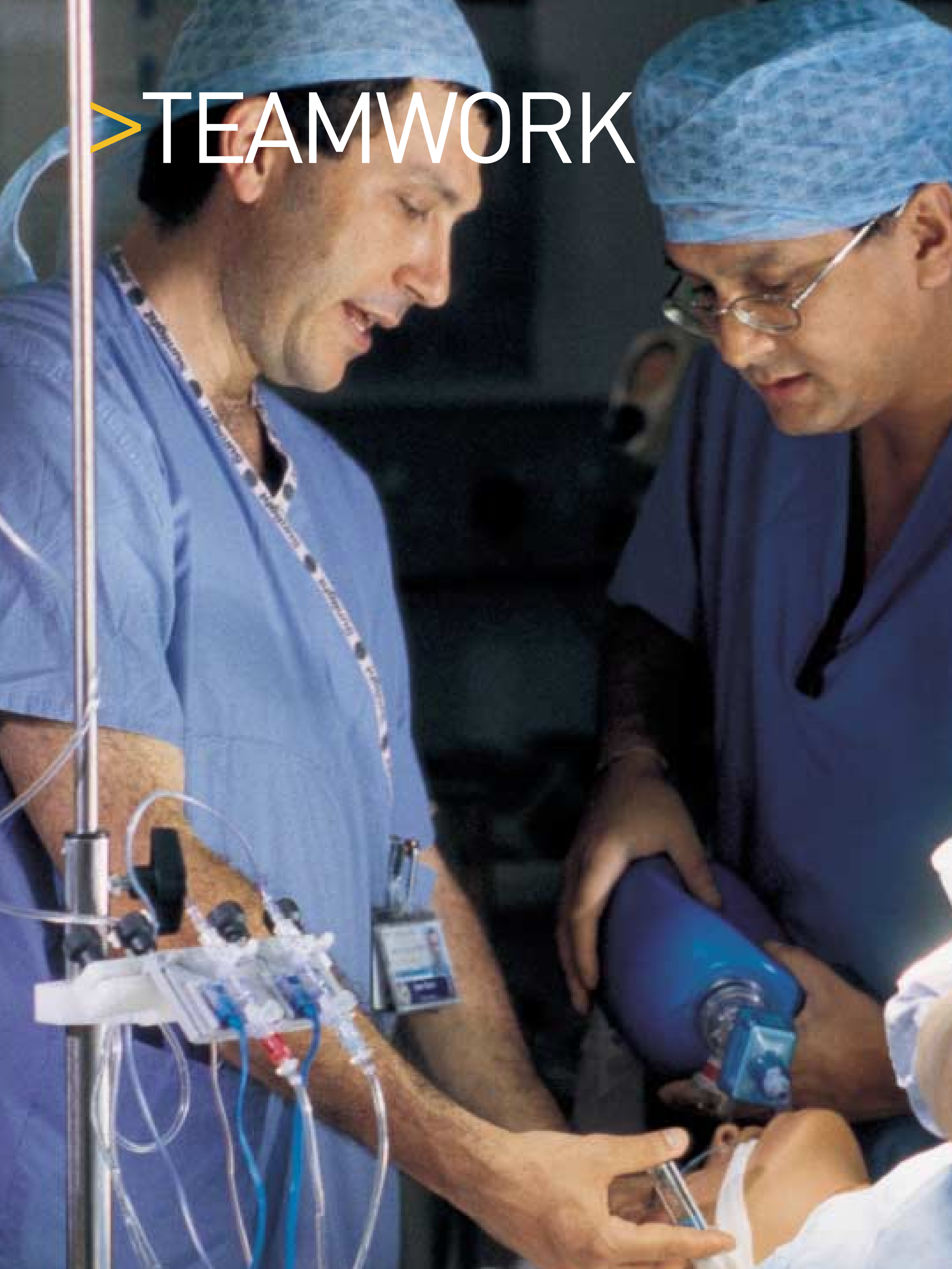
>Being prepared is everything. At Smiths we focus on the future. What will our customers want tomorrow? How can we exploit technology to provide enhanced solutions for their most demanding applications? How can we extend our capabilities to give them the service they need? We are constantly searching for ways to add value for our customers. This is how we generate profitable organic growth.

>DISCOVERY



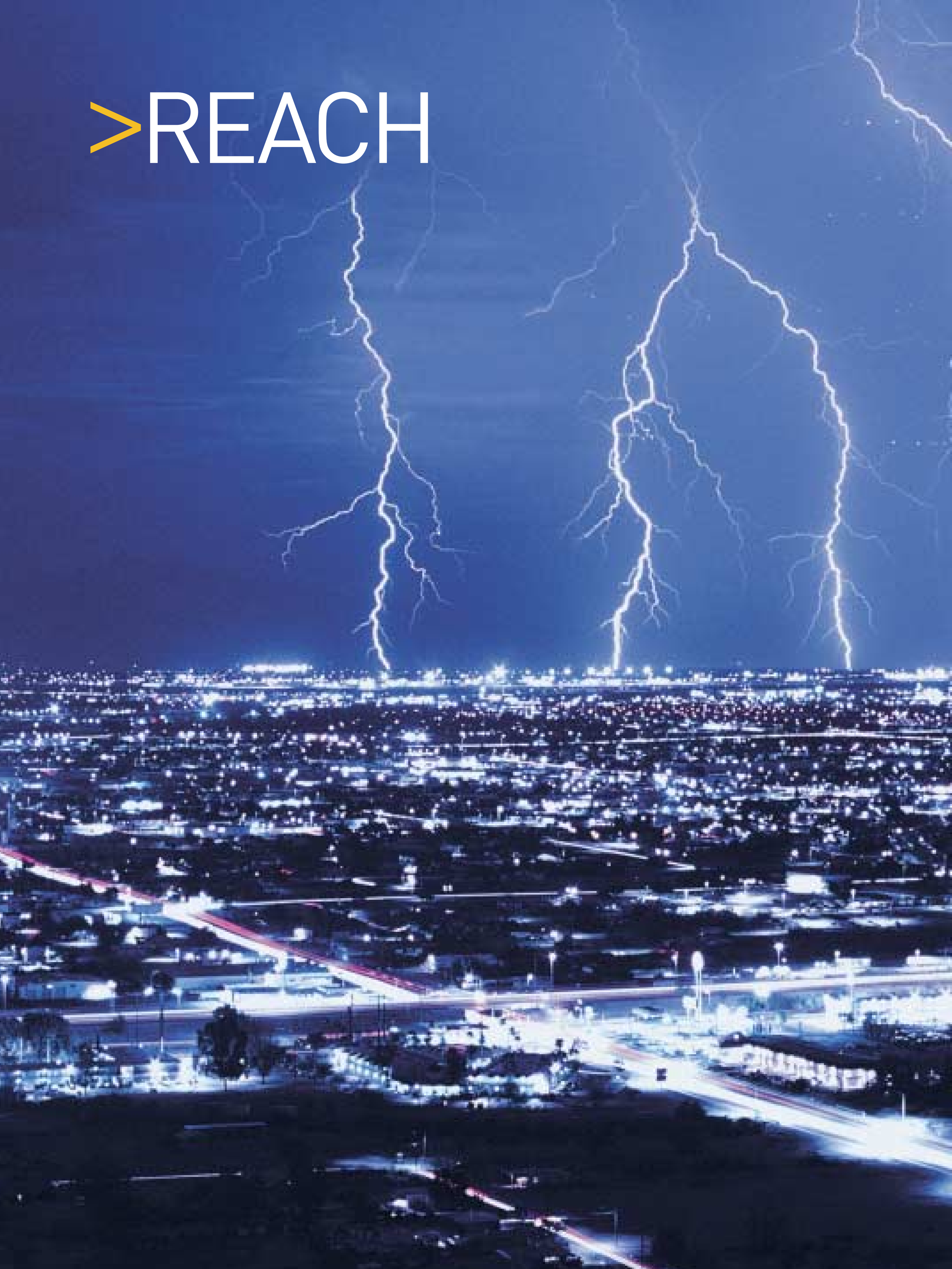
>Discovery is about being always one step ahead. It is about meeting needs in ways that others haven't yet thought of. It is about developing products that provide innovative solutions for the toughest applications. Through total commitment to research and development, Smiths seeks sustainable competitive advantage.

>TEAMWORK



>At Smiths we believe in teamwork. We work closely with our suppliers and customers to build productive partnerships and long-term relationships. Within the company, too, teamwork is essential. Not just working together day by day, but focusing everyone's efforts on maximum efficiency, productivity, flexibility and responsiveness. Through teamwork we seek to be a leader.

>REACH



> In a world where efficiency is paramount, customers want to deal with fewer, better suppliers. At Smiths we have the necessary size and diversity. We are global. Our products are wide-ranging. We have the reach to be our customers' preferred supplier.

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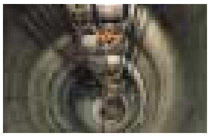
02   04

01 As a first-tier supplier working directly with prime manufacturers, we are delivering systems for front-line defence aircraft such as Eurofighter Typhoon.

02 Holding strong positions in world markets, our mechanical and polymer seals ensure reliability in critical processes, such as in oil and gas industries, and are backed with high levels of customer support and global distribution.

03 We are a leading supplier of products used during critical and intensive care procedures, and for continuing care during recovery.

04 Our solutions for demanding environments include high-integrity connectors and devices to protect communications and other equipment against power surges and lightning strikes.

smiths

>FORWARD

SMITHS IS A FORWARD-THINKING, FOCUSED ENGINEERING COMPANY WITH MARKET-LEADING POSITIONS WORLDWIDE IN ITS FOUR CHOSEN AREAS OF SPECIALISATION.

>SUMMARY PERFORMANCE 2001

>Operating profit on continuing activities up 13% to £525m.

>Increased sales and profits from all four divisions.

>Margins maintained at 15%, cash at 80% of profits.

>Dividend increased by 5% to 25.0p for the year.

>Successful demerger of Automotive.

>Restructuring in Aerospace and Sealing Solutions well under way.

	Total, including discontinued		Continuing activities	
For the 12 months to 31 July	**2001 £m**	2000 £m	**2001 £m**	2000 £m
Sales	**4,958**	4,653	**3,466**	3,062
Operating profit	**651**	622	**525**	465
Pre-tax	**535**	542	**448***	428*
Earnings per share	**68.3p**	68.6p	**57.4p***	54.2p*

before exceptionals and amortisation
*pro-forma

Contents

25p

	2001	2000	% change
Dividend (p)	**25.0p**	23.8p	+5%

12%

SMITHS GENERATED A 12% AFTER-TAX RATE OF RETURN ON TOTAL SHAREHOLDER INVESTMENT

Smiths Group is nearly twice the size it was when we reported a year ago, directly as a result of the merger with TI Group. Consequently, the figures in this Report and Accounts are all substantially increased, being the sum of the two parts. More significantly, these figures also show a strong increase over the previous performance of the equivalent, formerly separate, companies. The most important number to focus on for 2001 is the £525m of operating profits on the continuing activities, because this is the one that will allow the most direct comparison when looking forward and at last year. The Chief Executive therefore concentrates his report on the performance of these continuing activities.

However, I shall first detail the consolidated results of Smiths Group as it was for most of last year, which includes the discontinued activities, principally the now demerged Automotive business. On sales of £5bn, of which Automotive accounted for £1.5bn, Smiths earned operating profits of £651m. After interest costs of £116m, the pre-tax profit was £535m, resulting in earnings per share of 68.3p. All of these figures are reported before goodwill amortisation and exceptional charges, on which the Chief Executive gives a full report.

The Board is recommending a final dividend of 16.25p, bringing the total for the year to 25.0p, an increase of 5%, and a level of payment which is more than twice covered by earnings from the continuing activities alone.

The company's underlying good health will become apparent on reading the Financial Director's Review on page 27. A highlight of this for me is that last year the continuing Smiths activities generated a 12% after-tax rate of return on total shareholder investment, including goodwill, of £2.7bn. This is well above the company's cost of capital, and we are confident we can lift the rate of return still higher. Further reassurance can be found in the Directors' Report, where there is a full statement of the procedures for internal controls, audit and evaluation of potential risks to the business. These matters are regularly reviewed by the Board and we are confident we have robust systems in place.

The company answers to its shareholders for its financial performance: without their equity it could not exist. However, we recognise broader responsibilities, and we aim to report on these with the same degree of analysis as we do for our financial capital. This year, in the section headed 'Investing in global talent' on page 31, we detail how we value our human capital, make progress on health and safety, and meet our environmental obligations. We respect the legitimate interest of customers, suppliers, employees and our local communities in these topics.

The merger has doubled the number of people working for Smiths, but there have been no significant cultural issues from bringing the two companies together. We have worked hard to create an inclusive environment, stepping up our internal communications by introducing a company-wide electronic newsflow system. This lets employees know what is happening more quickly, and supplements well-established

THE SUCCESS OF SMITHS IS ENTIRELY THE RESULT OF THE ENTHUSIASM AND COMMITMENT OF OUR PEOPLE.

methods such as open-forum discussions with management. The success of Smiths is entirely the result of the enthusiasm and commitment of our people, and I would like to express here my appreciation of their support.

We took the opportunity to change the company's name slightly, taking the view that 'Industries' implies factories rather than technologies. It was done with minimal expense, and the new identity and presentational style can be seen throughout this document. I trust you will approve.

The Board was carefully rebalanced following the merger, to combine expertise from both TI and Smiths. There were two executive additions from TI: John Langston joined to run Sealing Solutions, where his prior knowledge will greatly benefit the essential restructuring; David Lillycrop joined as General Counsel, and is also Company Secretary. Three former TI non-executives also came across, bringing valuable industry, government and city experience: Sir Colin Chandler, Sir Nigel Broomfield and John Hignett. Colin is my deputy and Chairman of the Audit Committee, and I chair the Nominations and Remuneration Committee myself.

There are two strong features of this Board that I want to point out. First, we six non-executives provide real balance and external influence on Board deliberations, which are always lively and constructive. Secondly, our executive directors comprise the team with hands-on responsibility for the entire business. This gives us great insight into how Smiths is performing, together with a good grasp on future strategy.

The Chief Executive outlines our view of the prospects for the company at the conclusion of his Review overleaf. As we prepared this Report and Accounts, our uncertainty about which way the world's economies would go was compounded by the dreadful terrorist attacks in the US, which touched all of us. Even so, it should be clear to readers of this Report that Smiths has a great number of actions under way to improve our relative performance, and that shareholders will quickly see the benefit of this.

Keith Orrell-Jones
Chairman

Financial highlights of continuing activities

For the 12 months to 31 July	2001 £m	2000 £m
Sales	**3,466**	3,062
Operating profit*	**525**	465
Pre-tax*	**448**	428
Earnings per share*	**57.4p**	54.2p

*before exceptionals and amortisation

£188m

INVESTMENT IN RESEARCH AND DEVELOPMENT FOR THE CONTINUING ACTIVITIES TOTALLED £188M IN 2001

Smiths Group made significant progress in the year ended July 2001. In the first half we completed the strategically important merger with TI Group, which has substantially enlarged the company and in particular given it a much stronger position in the fast-consolidating aerospace industry. We then successfully demerged the TI automotive business, which – good performer though it is – was never intended to be part of the continuing enterprise.

These steps gave Smiths the shape that it now has: four strong divisions with excellent growth prospects and market-leading positions in aerospace systems, mechanical and polymer seals, medical devices and electronic interconnect components.

The result was that, at the end of the year, the company was able to deliver an improved operating performance directly in line with projections made when the merger was first proposed in September 2000. At the same time, we have also made rapid strides in reshaping and restructuring the entire business so that it is lean and competitive even in an uncertain economic environment.

To complete the picture, Smiths Group is again ready to meet the challenge of achieving the good margins, profits and cash-flow which have long been our track record, but now from a much higher baseline.

Focusing on the continuing activities, because this is how we shall be measured going forward, the company recorded operating profits of £525m, an increase of 13% from the previous year, on sales similarly increased to £3.5bn. The comparisons are with the same – but then separate – businesses now merged into the combined entity. After allocating a proportion of total interest costs to the discontinued activities, the pre-tax profit for continuing Smiths was up 5% at £448m, and earnings per share were 6% ahead at 57.4p. These earnings are before exceptional costs which I will explain overleaf, and also before amortisation of goodwill on acquisitions.

The four divisions all contributed to this improved performance, mainly as a result of organic growth and, in a clear signal of the company's good health, their average operating profit margin remained at a very satisfactory 15%. We spent £166m on new acquisitions to strengthen the divisions, and these made a part-year contribution of £9m to profits. We maintain a constant search for additions of this type, but our prudent requirement that they quickly recover their cost of capital leads us to reject far more than we finally acquire. We also sold a number of non-core businesses for £37m during the year, and several others since. This is the process by which we progressively improve the quality of our assets.

The restructuring I mentioned which has followed the merger has already started to yield benefits. Corporate offices from four locations have been consolidated into the existing Smiths' HQ in North London. Smiths Aerospace, which has brought together the Smiths and Dowty avionics and equipment businesses, has made rapid progress in eliminating overlap. Sealing Solutions is well advanced

THE COMPANY WAS ABLE TO DELIVER AN IMPROVED OPERATING PERFORMANCE DIRECTLY IN LINE WITH PROJECTIONS.

on relocating manufacturing to lower-cost countries. Together, these measures improved profit by £15m in 2001. The company is on target to raise the annualised savings to £50m in 2002 and £80m from 2003 onwards.

The matter of exceptional charges is quite complex – only to be expected following a merger of this size and the consequent reshaping of the company. The operational restructuring of the continuing activities described above led to a charge of £116m. The expenses of the merger itself were £54m, and the charge for restructuring Automotive prior to its demerger was £18m. Altogether, the exceptional charges with a cash impact came to £188m before tax relief, or £150m net. We then took a write-down on the value of assets being sold and a goodwill adjustment on a number of others, including the former EIS businesses, which were part of TI. These gave rise to a non-cash exceptional charge of £411m, of which the demerger of Automotive accounted for £299m.

The company's net debt at year-end stood at £1,120m, after receipt of the £615m cash consideration for the Automotive transaction in July. Including both continuing and discontinued activities, interest costs for the year were £116m. Operating cash-flow was £513m after capital spending of £188m. The high level of cash-flow generated by all our divisions gives us considerable flexibility to reduce debt or use the money as acquisition currency.

Our commitment to technology leadership is a fundamental principle. Investment in research and development for the continuing activities totalled £188m in 2001, of which £91m was directly charged against profits, with the balance recovered from customers. The majority of research and development is carried out in Aerospace, but a growing proportion is spent on developing new medical devices to keep Smiths Medical at the forefront of technology in its field.

There are 37,700 people now working for Smiths, and we have a wide geographical spread of activities. Continuing US operations generated 52% of the profit, while the UK accounted for 25%. Half of UK output, worth £600m, was directly exported. Looked at by market, Aerospace contributed 40% of the profit, Sealing Solutions 24%, Medical 18% and Industrial 18%.

Keith Butler-Wheelhouse

Aerospace

	2001 £m	2000 £m
Sales	**1,329**	1,145
Operating profit	**210**	178

Our sales in Aerospace rose 16% compared to the separate Smiths and Dowty Aerospace sales of a year earlier. Profit increased by 18%, reflecting buoyant demand for original equipment on new aircraft, and for upgrades and aftermarket support of aircraft in current operation. Sales of machined components for aircraft engines also increased.

Business on commercial aircraft remained healthy through this period, while defence sales continued their upward trend. Among several significant programme wins, we were selected by Boeing to help upgrade the avionics on the USAF's fleet of over 500 C-130 military transport aircraft, an order worth more than $250m.

We made two acquisitions for the division during the year, both in the US: Fairchild Defense, which cost £75m and makes data recording and analysis systems for military aircraft; and Barringer Technologies, costing £39m and making explosive and narcotic detection systems. They complement existing activities in these sectors. The increased threat of terrorism is being addressed by our Detection and Protection Systems business, with new equipment to identify dangerous substances being carried through airports.

Completing the integration of the original Smiths and Dowty aerospace businesses, Smiths Aerospace has now been organised into six customer-focused business units: electronic systems, actuation systems, precision components, customer services, detection and protection systems, and naval and marine systems. The restructuring will contribute to performance improvement in 2002 and beyond. Significantly, the more highly integrated systems now being offered to the aircraft prime manufacturers as a result of the combination are securing incremental orders.

While Aerospace performed strongly last year, the immediate outlook for the civil part of the business has deteriorated since the events of 11 September. Original equipment and aftermarket sales into this sector, £600m last year, are likely to be affected in the period ahead. In contrast sales of defence equipment, for which the company has a secure order book, continue to grow strongly.

Sealing Solutions

	2001 £m	2000 £m
Sales	**1,165**	1,064
Operating profit	**128**	121

Our sales in Sealing Solutions improved by 10%, and the profits by 6%. After a strong first half, the division was later affected by a slowdown in some of its market sectors, particularly in the US and for industrial products in Europe. Margins remained at 11%, with the benefit of the current restructuring only showing through in the current year.

Among the initiatives already under way are the relocation of high volume, labour intensive production from the UK and France to the Czech Republic, and from the US to Mexico. We are in the process of divesting a number of low-margin activities.

Viewed more closely, Sealing Solutions has operations involved in mechanical, polymer and marine sectors.

The largest, John Crane Mechanical Seals, increased its world market leadership in the metal and ceramic rotating seals used in process industries and in a range of high-volume industrial applications. While sales in oil, gas and petrochemical markets benefited from increased capital spending, the gain was offset by reduced demand for other industrial products, including vacuum and filtration systems, now in the process of being sold. John Crane's margins, which had fallen in recent years, have now been stabilised and will improve as the restructuring takes effect.

Polymer Sealing Solutions, specialising in high-technology plastic and rubber seals, achieved modest growth on the previous year. Sales increased in aerospace, medical and industrial applications, but sales into the automotive market were reduced.

Both John Crane and Polymer improved their competitive positions with new products for high-potential markets and by moving rapidly into e-commerce for their sales activity.

John Crane-Lips performed strongly last year, responding to healthy demand for its marine systems. The alliance with Finnish marine diesel-maker Wärtsilä

THE EXPANSION OF THE HEALTHCARE SECTOR THROUGHOUT THE DEVELOPED WORLD IS LIKELY TO CONTINUE WITHOUT PAUSE.

generated a substantial order book for combined power and propulsion units.

Looking ahead, we expect that organic growth in Sealing Solutions will be broadly related to GDP in its principal markets, although the cost savings we aim to achieve within the next two years will lead to an improvement in margins.

Medical

	2001 £m	2000 £m
Sales	**453**	403
Operating profit	**93**	85

In North America, Europe and most other advanced economies, healthcare has risen to the top of national agendas, bringing greatly increased spending by both government and private health providers. In particular, world market demand is growing at 6% per annum in the medical device sector. Against this background, our medical business performed strongly in 2001, achieving a 12% increase in sales and a 10% increase in profits. We have excluded Eschmann, a business making operating tables, from the comparison, because it was sold during the year for £11m.

We maintained our long-held record of margins above 20% for the Medical division. They have been kept at this level through constant productivity improvement and new product introductions, outpacing any price erosion on mature products.

Sales growth was strong in the largest business sector – single-use products for patient airway management – helped by greater demand for specialised procedure kits. These higher added-value packages are increasingly preferred by busy anaesthetists for the convenience they provide during critical-care procedures.

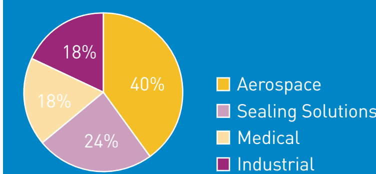
Another significant area of growth was in needle-protection devices, which prevent nurses and clinicians from injuring themselves with used needles. Recent US legislation now requires all hospitals to use safe-closure devices such as our Portex Needle-Pro, of which we delivered 120 million units from the US business during the year.

The Deltec ambulatory infusion pumps are selling well, and we secured major long-term supply agreements with three of the largest US healthcare groups. The enlarged user base of pumps is generating valuable continuing revenue from the disposable cassettes containing the medication. These ambulatory pumps are gaining acceptance in markets outside the US, including Japan. In the UK, the Graseby pole-mounted pumps used at hospital bedsides have benefited from NHS budget increases.

Our recent reorganisation of the division has established global business units – each focused on a specific therapy. The benefits will include: more rapid introduction of new products and their roll-out into world markets; increased focus on major national accounts; and further production efficiencies, including transfer of labour-intensive work to Mexico.

We are confident these measures will help Medical to grow strongly in a dynamic market. The expansion

Profit by division
%



£166m

WE SPENT £166M ON NEW ACQUISITIONS TO STRENGTHEN THE DIVISIONS

of the healthcare sector throughout the developed world is likely to continue without pause, regardless of general economic trends.

Industrial

	2001 £m	2000 £m
Sales	**520**	450
Operating profit	**94**	81

With sales and profits both up 16%, our Industrial division continued to grow strongly, retaining margins of 18%. Half of the improvement was like-for-like growth, the balance being the full-year benefit of acquisitions made in the previous year. In December we acquired the US antenna company Radio Waves and in March we sold our Hydraulics business.

Interconnect now generates two-thirds of Industrial's profits, and our businesses in this sector continued to thrive. Involved in the connection and protection of sensitive electrical and electronic equipment, they grew their sales in a wide range of applications including aerospace, defence, satellite, medical, rail and other specialised industrial sectors. Among important developments was the step-up in production of filtered Hypertac connectors for the Eurofighter Typhoon, a valuable long-term contract.

Interconnect also serves the market for wireless broadband and mobile communications infrastructure, and this part of the business, like many others, was affected by the global telecoms downturn. About one-fifth of Industrial's sales are into this market, and even at the lower sales levels recorded in the second half, they achieved high levels of profitability. Indications are that infrastructure spending for 2.5 and 3G systems will continue, albeit at a slower pace.

Our Air Movement businesses were in steady-state during 2001, operating in difficult trading conditions but remaining highly cash-generative and with strong competitive positions. UK market leader Vent Axia introduced new low-energy, environmentally friendly ventilation fans, which have been well received by building equipment specifiers. The Flex-Tek businesses in the US gained market share with innovative products for household equipment.

Six businesses have joined and helped transform Industrial over the past two years, and their integration is progressing well. All of them are based in the US and have now started to build significant exports, particularly into Europe.

Industrial enjoys excellent margins and generates cash-flow closely related to profits. Its outlook remains positive, with the broad range of interconnect applications being the principal driver.

Prospects

In summary, the year marked a great stride forward for Smiths Group. The company is larger and stronger, but retains the long-held virtues for which we have always been recognised: profitable growth, excellent margins, exemplary cash generation and a sound balance sheet. Moreover, we have the ability to restructure quickly and focus investment on areas of greatest opportunity. It is a proven formula, and the best way we know of delivering value to shareholders.

We recognise that the prospects for the world economies are uncertain at present, and Smiths is not immune to these external market forces. The civil aerospace business, less than 20% of sales, will be most directly affected. However, the company's wide spread of activities from defence to healthcare, strong market positions, increased competitiveness from restructuring and its emphasis on cash-flow all contribute to its greater resilience during more difficult trading conditions. The company is confident that it can continue to outperform in the period ahead.

Keith Butler-Wheelhouse
Chief Executive

IN EACH OF ITS FOUR BUSINESSES, SMITHS IS A WORLD LEADER. WITH CUSTOMERS RANGING FROM DEFENCE CONTRACTORS TO PETROCHEMICAL COMPANIES TO HOSPITALS, THE BUSINESSES SHARE A COMMON PHILOSOPHY. THEY ANTICIPATE AND SATISFY CUSTOMER NEEDS THROUGH INNOVATION, PARTNERSHIP AND GLOBAL SCALE.

BUSINESSES

Aerospace
Smiths Aerospace is a first tier supplier of integrated equipment and systems to aircraft prime manufacturers and engine builders. Its sales are balanced between military and civil aircraft programmes.

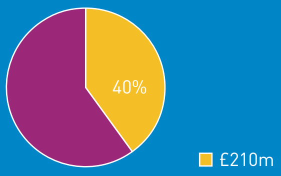
Sealing Solutions
Sealing Solutions is a world leader in the design of high performance mechanical and polymer seals for industries including automotive, oil and gas, petrochemical, marine, and pulp and paper.

Medical
Smiths Medical is a leading supplier of devices used during critical and intensive care procedures and for post-operative care during recovery. There is a focus on specific growth markets, particularly in single-use disposable devices.

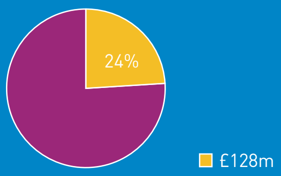
Industrial
Industrial is focused on two specialised market sectors. Interconnect supplies electronic connectors for defence, transport, telecommunications and other industries, while Air Movement products include ducting and ventilation systems.

PROPORTION OF GROUP PROFIT

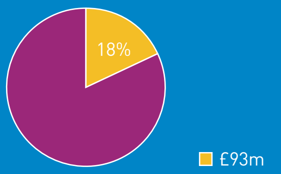
Aerospace



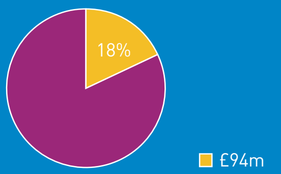
Sealing Solutions



Medical

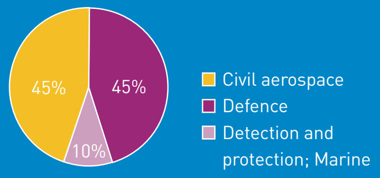


Industrial

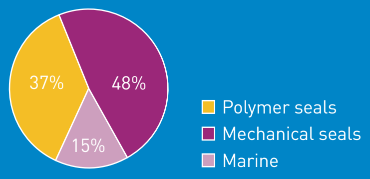


SALES BY ACTIVITY

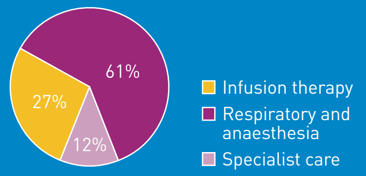
Aerospace



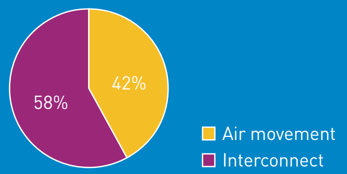
Sealing Solutions



Medical



Industrial



"DURING THE PAST YEAR WE HAVE CREATED A $2 BILLION AEROSPACE EQUIPMENT COMPANY THAT IS THE LARGEST TRANSATLANTIC ENTITY IN THIS INDUSTRY."

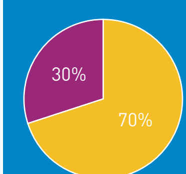
Dr John Ferrie
Group Managing Director, Aerospace

Aerospace

	2001 £m	2000 £m
Sales	**1,329**	1,145
Profit	**210**	178

Employees: 12,700

Aerospace: Sales by market



01 Smiths will supply flight management systems and other key avionics from UK and US facilities to Boeing for its contract to upgrade 500 US Air Force C-130 transport aircraft.

02 In contracts valued at $250m, Smiths is supplying electrical generators and drive actuation systems for the gun and turret of the US Army's Crusader howitzer programme, due in service in 2008.

03 For 90 Sea King helicopters of the Royal Navy, Smiths teams will work on a £40m contract to design a GenHUMS system for continuous monitoring of safety-critical components.

04 Smiths is a key supplier of precision gas turbine engine components to the world's major aircraft engine makers.

Aerospace

Created from the merger of Smiths Industries and TI, Smiths Aerospace had a landmark year. Buoyant orders from both military and civil customers contributed to double-digit profit growth. The division has made significant progress in integrating the two businesses. It now has the scale and diversity to command an increasing share of the market for integrated aircraft systems, despite an imminent slowdown in the civil sector of the market.

Performance review

The division performed well during the year through a combination of organic growth and acquisition. Sales increased by 16% to £1,329m and operating profits by 18% to £210m. There were robust levels of orders across the businesses. This strong performance reflects the competitiveness of products following previous investment in product and manufacturing capabilities. Additionally, businesses acquired during the year made a valuable contribution to turnover and profits.

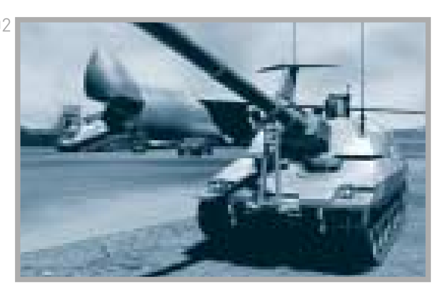
A number of important contracts were won. In the military sector, Smiths Aerospace was selected by Boeing to supply key avionics systems for the modernisation programme of more than 500 Lockheed Martin C-130 military transport aircraft in US Air Force service. The division was also awarded two contracts to supply avionics to Indian Air Force jets. Both contracts were for 'open architecture' systems, which facilitate the development of more integrated avionics equipment. Winning such contracts bolsters Smiths Aerospace's position as a first-tier supplier of systems to military and civil aircraft.

There was a growing volume of sales supplying mainstream military aircraft. Production delivery of mainly avionics equipment has started for the Eurofighter Typhoon and orders are expanding on a wide range of equipment for US fighter planes, including the F-16, F-18, and F-22. The division's position as a supplier to both the Lockheed-Martin and Boeing aircraft competing for the Joint Strike Fighter programme was also further developed. In recognition of Smiths Aerospace Actuation Systems' product quality, on-time delivery and responsiveness, Lockheed Martin's missile and fire control division recognised the company as one of only two 'gold' suppliers under its preferred supplier initiative.

In the civil market, Smiths Aerospace competed strongly to

01

02



03

500

SMITHS WAS SELECTED TO SUPPLY KEY AVIONICS SYSTEMS FOR THE MODERNISATION PROGRAMME OF MORE THAN 500 C-130 MILITARY TRANSPORT AIRCRAFT

04

supply components to both Airbus and Boeing aircraft. Smiths Aerospace Actuation Systems won an order from Goodrich, the US aerospace company, to provide the entire hydraulic actuation package for the body and wing landing gear on the new Airbus A380 aircraft. The Smiths Aerospace Electronic Systems business has been selected to develop electrical load management and fuel quantity indication systems for the Boeing 777 derivative.

Health and usage monitoring systems (HUMS) were also in demand. Contracts were received for installation on the Bell 412 helicopter, UK Royal Air Force Chinook helicopters and the Royal Navy's entire fleet of Sea King helicopters.

The Components business benefited strongly during the year from increased outsourcing of engine and airframe components from key customers such as General Electric and Boeing.

Within Marine Systems, Kelvin Hughes won a prestigious order to provide the integrated bridge system for Cunard's Queen Mary II luxury cruise liner, which is currently under construction. Chartco, the joint venture company with Fugro, has now secured a total of over 500 orders for its unique digital navigation data and information update service.

Strategic development

Following the merger of the Dowty and Smiths Industries aerospace businesses to form Smiths Aerospace, the division has embarked upon an extensive integration process. There are now six business areas centred on particular customer solutions: Electronic Systems, Actuation Systems, Components, Customer Services, Detection & Protection Systems, and Marine Systems. Key account managers have been appointed to ensure customer satisfaction across the Aerospace division.

Considerable progress has been made in the adoption of lean principles into all areas of the division. These techniques are improving flexibility, customer service, inventory management and cost control. A major new programme of training to support the transformation of the business into a lean enterprise has been launched.

The division has also continued to make strategic purchases. Two acquisitions in North America extended Smiths Aerospace's product range and provided access to new customers. In October, Fairchild Defense was acquired for £75m, enhancing Smiths' leadership in data recording and transfer, and strengthening the rapidly growing HUMS, mission planning and related product ranges. In May, Barringer Technologies, a specialist in explosive and narcotic detection equipment, was bought for £39m. This acquisition provided access to civilian security markets and added to Smiths' leading global position in chemical and biological detection systems.

In April, Smiths Aerospace Customer Services, which provides a valuable link with end users of the division's technology, expanded its global reach with the acquisition of Chapman Avionics, an important Australian independent maintenance provider.

Balanced portfolio

In the immediate future, the strengthening of the defence sector will provide some counter to the imminent weakening of the civil aircraft market. A strong forward military order book provides valuable business many years into the future.

The division's balanced military and civil portfolio, the widely recognised quality of its products, and its ability to supply from both sides of the Atlantic put Smiths

scale reach and strength

"SEALING SOLUTIONS HAS BEEN SUCCESSFULLY INTEGRATED WITHIN SMITHS GROUP. THERE IS A CLEAR STRATEGY TO ACHIEVE GROWTH AND TO RESTRUCTURE THE BUSINESS TO ACHIEVE SIGNIFICANTLY HIGHER MARGINS WITHIN A TWO-YEAR TIME FRAME."

John Langston
Group Managing Director, Sealing Solutions

Sealing Solutions

	2001 £m	2000 £m
Sales	**1,165**	1,064
Profit	**128**	121

Employees: 14,900

Aerospace in a good position to increase market share in years to come.

The division plans to continue investment in product research and development. This, along with investment in new production capabilities, will drive organic growth in the medium term. Aftermarket support services and upgrade programmes principally for military aircraft already in service are expected to generate a valuable income stream.

Strategically, the transformation of the aerospace supply chain now taking place will undoubtedly provide new business opportunities and challenges. The division will continue to seek targeted acquisitions, but only where this will create shareholder value through better access to technology, enhanced market coverage or increased access to funding.

Sealing Solutions

Sealing Solutions further strengthened its leadership position in its chosen markets. A major restructuring programme, which was initiated in all three operating businesses, will underpin future profitability.

Performance review

The division's financial performance was robust. Sales grew by 10% to £1,165m, and operating profit by 6% to £128m, while almost all profit was converted into cash.

John Crane Mechanical Seals, the largest operating business, benefited as high energy prices stimulated increases in capital expenditure in the oil and gas industry. John Crane is the world leader in the design, manufacture and servicing of complex mechanical seals for use in many industries, including automotive, chemical, oil and gas, power and energy, pulp and paper, and water. The business won a significant share of the year's new contracts to supply major oil, gas and petrochemical projects. The biggest contracts include orders to supply seals for a Lyondell project in The Netherlands and to Iran's Buali Sina Aromatics plant. Demand was also strong in the pulp and paper industry, although total demand for seals was damaged by weaker activity in the industrial and automotive sectors.

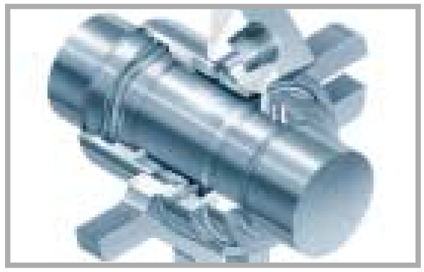
John Crane introduced Performance Plus, a major initiative designed to strengthen and transform its relationship with key customers. Through Performance Plus, facilities including oil platforms and petrochemical plants sign long-term, fee-based service contracts with a consortium of companies led by John Crane. Such contracts, which have already been signed with companies including Shell and BP Amoco, enhance the operating performance of a facility by improving the performance of individual components.

01


01 Detection & Protection Systems was expanded with the acquisition of Barringer, a specialist in devices to detect substances including explosives, narcotics and chemical warfare agents, being carried through high security areas such as airports.

02

03



4610

JOHN CRANE'S NEW 4610 MECHANICAL SEAL TAKES THE DIVISION INTO ATTRACTIVE NEW MARKET SEGMENTS

Polymer Sealing Solutions expanded sales, although growth was restricted by falling demand in the North American automotive market, and the industrial markets of Europe. The Polymer business designs and manufactures sealing solutions in rubber and plastic materials for the aerospace, automotive and industrial markets. There were major contract wins in all three of these markets, with clients including Baxter Medical, Caterpillar, Honeywell, Jaguar, TRW Aeronautical Systems in France (which awarded a three-year sole source supply agreement), and TRW Automotive (which supplies Fiat, Nissan and Peugeot).

Both John Crane Mechanical Seals and Polymer Sealing Solutions continued to invest strongly in new product development. John Crane's new 4610 mechanical seal and Polymer's high temperature Isolast seals took the division into attractive new market segments. The businesses also stepped up their e-commerce activities. A global e-procurement initiative was launched, while on-line trading with customers increased.

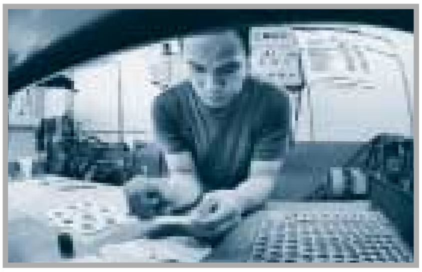
John Crane-Lips, which supplies marine propulsion systems to the worldwide merchant and naval marine markets, enjoyed good sales growth. It won contracts with major Asia-Pacific shipyards including Hyundai Mipo and was awarded new contracts by several navies: the business now supplies 73 navies throughout the world.

The outlook for this business is encouraging following the October 2000 formation of an alliance with Wärtsilä, the Finnish marine diesel company. The two companies supply entire marine power-propulsion systems, from engine to propeller. This meets the requirements of owners and shipyards, which are increasingly delegating responsibility for power-propulsion systems to single suppliers. Since the alliance was signed, the combined Wärtsilä/John Crane-Lips power-propulsion systems have been ordered for some 50 new ships.

02 John Crane's Performance Plus business is building strategic alliances with key customers by taking long-term responsibility for product supply, performance and maintenance in oil, gas and other processing plants world-wide.

03 The 4610 cartridge seal is the result of John Crane's continuous product development programme. This advanced seal reduces maintenance and running costs for customers, replacing more costly and less efficient products used on pumps and rotating shaft equipment.

leaders
through knowledge

01


02


01 The US Polymer business Forsheda Palmer Chenard provides complete assemblies for regulating aircraft cabin pressure. Its customers are the first-tier suppliers to the aerospace industry.

02 Isolast elastomer seals that withstand temperatures up to 325ºC have wide application in chemical processing, oil and gas, and semiconductor industries. Investment in precision production caters for exceptionally short lead times and high raw material costs.

Margin enhancement

The division has launched a series of major initiatives to improve profitability through a combination of reorganisation and more targeted sales and marketing. Restructuring programmes will lead to total annual savings of around £30m, while sales initiatives are being focused on the most profitable and fastest-growing market segments.

In John Crane, restructuring has included moving the manufacture of labour-intensive components from Western Europe to the Czech Republic, and automotive and other high-volume components from the US to Mexico. Costs were also reduced by relocating a good proportion of drawing office capability from Europe to India.

In Polymer Europe, restructuring initiatives were focused on consolidating product lines, introducing more lean manufacturing, and outsourcing non-core products. In Polymer North America, the unprofitable pipe seal manufacturing plant was closed and overheads were reduced.

Resilient sales

With firm order books, sales should continue to hold up despite an unsettled economic environment. Active steps taken to restructure and refocus Sealing Solutions will increase the profitability of the business over the coming year.

"WITH ITS SHARPENED FOCUS ON CUSTOMERS AND THERAPIES, SMITHS MEDICAL HAS GREAT POTENTIAL TO INCREASE ITS RATE OF ORGANIC EARNINGS GROWTH IN THE YEARS AHEAD."

Lawrence Kinet
Group Managing Director, Medical

Medical

Smiths Medical achieved strong sales growth in a period of robust spending by healthcare providers. The division has been reorganised into therapy-driven global business units in order to increase sales of its leading-edge medical devices throughout the world. Looking forward, there are also opportunities to increase profits by streamlining manufacturing and distribution.

Operating performance

Smiths Medical's profits advanced significantly in a period of strong market demand. Sales grew by 12% to £453m, outpacing the market growth rate of 6% in all core areas. Operating profit climbed by 10% to £93m. Margins remained at a high 21%. There were buoyant sales in growth areas such as needle protection and infusion, where Smiths products offer both superior performance and innovation. The division also benefited from increased spending by the UK National Health Service (NHS).

clear and focused vision

The division operates in markets characterised by high levels of technological innovation. In order to increase market share and maintain high margins, Smiths Medical invests in research and development and regularly introduces new, value-added products.

A number of long-term market trends support growing demand for the division's devices. In particular, many of Smiths Medical's businesses benefit from the health industry's growing belief that single use of devices such as tracheostomy tubes reduces risks of cross-infection.

A heightened awareness of the danger to hospital staff from contaminated needles boosted sales of needle protection devices during the year. In April 2001, the US Needlestick Safety and Prevention Act became effective, making needle protection compulsory. The Portex subsidiary experienced a dramatic increase in sales to hospitals across the US. Notably, it was selected to supply needle protection devices to the 1,850 hospitals controlled by Premier, a leading US alliance of hospitals.

In the ambulatory infusion business, a reputation for quality, reliability and innovation helped generate increased sales. Supply agreements with US healthcare groups Gentiva Health Services, Broadlane and Premier are expected to lead to the sale of more than 5,000 Deltec ambulatory infusion pumps over the next five years. Once new pumps are installed, sales of related disposable items can be expected to follow quickly.

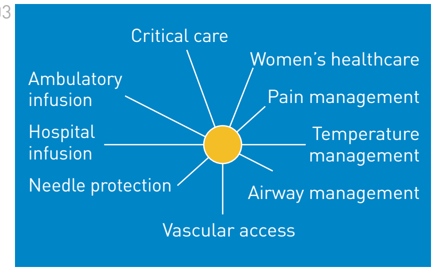
At the same time, Graseby's hospital infusion business was assisted by growth in NHS spending. Sales of vascular access ports also remained strong.

Airway Management, the largest business unit, experienced strong sales of procedure kits for anaesthetists. Steps were taken to build Airway Management's sales and marketing community and to develop new products and services. The unified portfolio opens important global opportunities. In particular, it is anticipated that many existing UK products will be launched in the US in the near future, and vice versa.

Strategic reorganisation

Smiths Medical has been reorganised into nine global business units in order to sharpen customer focus, to specialise in specific therapies, to strengthen global market positions in identified healthcare sectors, and to accelerate the assessment of new opportunities. The nine business units are: Airway

03



04

03 New therapy-driven organisation. Smiths Medical is now organised into nine global business units, aligned to specific therapy areas, which will strengthen the division's market position in healthcare worldwide.

04 An example of investment in technology is the latest range of paediatric apnoea monitors, incorporating pulse oximetry, from Graseby Medical. They monitor a baby's respiration, heart and pulse rates plus blood/oxygen levels. An alarm warns the nurse or parent of irregularities.

05 Another exciting product development is this miniaturised pulse oximeter from BCI. Known as the Digit, it may be worn around the neck or carried in a pocket. Doctors and paramedics can now measure a patient's blood/oxygen levels, pulse strength and pulse rate in hospital, the home or in emergency situations.

Medical

	2001 £m	2000 £m
Sales	**453**	403
Profit	**93**	85

Employees: 4,800

05

5,000

SUPPLY AGREEMENTS WITH US HEALTHCARE GROUPS WILL LEAD TO SALES OF MORE THAN 5,000 DELTEC AMBULATORY PUMPS

03

01 New products from Level 1, which makes technologically advanced fluid-warming systems to help stabilise patients during surgery, emphasise that temperature management is a key focus area for Smiths Medical.

02 US legislation to reduce the risk of infection through accidental injuries from used needles boosted Needle-Pro sales during the year, with 120 million of these devices sold to hospitals and other customers.

03 Many Smiths Medical businesses are benefiting from the health industry's growing recognition that single-use devices reduce the risk of cross-infection.

01

Management, Pain Management, Needle Protection, Temperature Management, Critical Care Monitoring, Hospital Infusion, Ambulatory Infusion, Vascular Access and Women's Healthcare.

The division pursued a policy of investing in markets where there is sustainable growth. In August, Portex acquired the Point-Lok Needle Protection Device, a versatile protection product that can be used on a variety of needle types. Eschmann Equipment was sold in June, as its specialisation in capital equipment for hospitals did not fit with the division's core strategy.

Action was taken to reduce costs, with further production transferred to the division's lower-cost facility in Tijuana, Mexico. Cost-effective, high quality manufacturing remains an important part of Smiths Medical's strategy. It means that profitability can be maintained while the division invests heavily in new product development.

02

Detailed strategy

Smiths Medical now has a stronger global product range and an organisational structure that is more closely focused on meeting customer requirements. There is a detailed strategy to concentrate on growth markets, to seek manufacturing efficiencies and to increase the pace of new product introductions. Product and marketing strategies are now coordinated on a global basis. Management has been strengthened in the areas of national accounts and corporate sales.

With the expansion of the healthcare sector throughout the developed world, Smiths Medical is confident that the market for single-use devices will continue to grow. Against this background, actions taken to focus and to energise the division, along with prudent cost control, should lead to continued strong earnings growth.

"EFFECTIVE POST-ACQUISITION MANAGEMENT HAS YIELDED SUSTAINED HIGH MARGINS AND STRONG CASH GENERATION. SMITHS INDUSTRIAL WILL CONTINUE TO FOCUS ON GROWTH THROUGH TARGETED ACQUISITIONS AND THROUGH PRODUCT AND PROCESS INNOVATION."

Einar Lindh
Group Managing Director, Industrial

Industrial

	2001 £m	2000 £m
Sales	**520**	450
Profit	**94**	81

Employees: 5,300

Industrial

Smiths Industrial benefited from a strong performance from Interconnect despite the softening of telecoms markets in the second half. Future priorities are to build further on the division's niche product businesses and to improve productivity and competitiveness through continuing process and design innovation.

Performance review

Smiths Industrial achieved good growth in both sales and profits. The division increased sales by 16% to £520m, with operating profits rising by 16% to £94m. In the second half of the year, the US economic downturn and weakness in the telecoms sector affected some businesses, but this was counterbalanced by buoyancy in industries such as defence, aerospace, transport and medical.

Interconnect's sales increased significantly as demand for mission-critical connectors continued to grow. More than half of Interconnect's sales are for high-tech applications such as military, aerospace and satellite markets, and these grew strongly during the year, partly reflecting resurgent defence budgets. Like other suppliers, Interconnect saw sales decline for products sold into the telecom sector in the second half of the year.

Connecticut-based Times Microwave Systems was one of several businesses that increased sales to defence contractors. European defence projects also proved important, as Hypertac UK, in collaboration with California-based Sabritec, began to deliver filtered connector technology for Eurofighter Typhoon.

Air Movement continued to experience difficult trading conditions. However, there were several areas of sales growth. Tutco, the specialist air heating business, gained market share by increasing sales in a slow market. Vent-Axia ventilation, which is a leader in heat recovery technology, introduced new environmentally efficient products and low-energy versions of its market-leading brands.

There were a number of promising commercial, product and process initiatives across both major business areas. Activities increased in the emerging growth markets of China and Brazil. In terms of product innovation, defence applications are using Interconnect's growing fibre-optic capability. Meanwhile, Air Movement's exploitation of new polymers and processing technologies continues to yield new products with key specialist applications and good margins.

04


05


04 Among environmentally efficient products introduced by Vent-Axia is a whole-house heat-recovery unit, first installed in apartments in Japan, providing warmth in winter and cool air and ventilation in summer.

05 Icore International is developing its interconnect technologies for highly specific applications, such as improving the quality of in-flight entertainment systems.

innovative solutions

ACQUISITIONS

AN IMPORTANT THEME FOR SMITHS INDUSTRIAL WAS THE INTEGRATION OF ACQUISITIONS MADE DURING PREVIOUS YEARS

01

02

01 Used in many industries to ensure firm electrical or electronic connections in moving or vibrating environments, Interconnect's high-integrity Hypertac connectors are widely used in rail traction and signalling applications.

02 Flexible Ducting's innovative silicon hose, weighing only a quarter of the rubber equivalent, has applications worldwide and is already supplied to the world's largest milking-machine manufacturer.

Further introduction of process efficiencies continued to shrink inventory and cost levels while improving customer service.

Successful integration of acquisitions

An important theme was the integration of acquisitions made during previous years. Substantial progress was made, with particular emphasis on boosting the European sales of US companies acquired by Interconnect.

Entraco, acquired in 1998, was combined with the existing US Icore business. The resulting Icore-Entraco operation offers integrated solutions for customers seeking rugged conduit and connector interface products.

The programme of focusing on growth areas continued, with the acquisition of Radio Waves, a leading US supplier of antennae for high-frequency microwave communications, for $25m. Despite the current telecoms downturn, Radio Waves has excellent long-term prospects, with product ranges targeting markets such as broadcast and hub-to-subscriber links.

The non-core industrial hydraulics business, located in the UK, was sold to SPX Corporation, a US specialist in this area, in March.

Growing demand

Industrial has good prospects of continuing growth with sustained high margins and strong cash generation. While sales to the telecoms industry are likely to decline in the short term, there is growing demand for robust high-density and high-frequency connectors from a range of other industries. Air Movement's innovative products are also well positioned to benefit from trends such as the burgeoning demand for environmentally efficient ventilation systems.

The division will continue to concentrate on growth markets. It will improve profitability through targeted acquisitions, product development and process innovation.

2001 has been a year of intense corporate activity. The merger of Smiths Industries and TI Group was finalised in December. The demerger of the Automotive Systems division was announced in March and completed in early July. Several small, non-core businesses were sold, and two others have been sold since the year-end.

Following the merger, integration teams were established for Aerospace, Sealing Solutions and Head Office.

Accounting for the merger

Under merger accounting, the results are presented as if the two companies had always been combined. In contrast to acquisition accounting, the balance sheets are merged without establishing new 'fair values'. After a merger, the accounting policies of the predecessor companies are reviewed and material differences are adjusted as at the merger date. Smiths Group had no material differences and thus made no adjustment, other than to align the date from which goodwill has been capitalised.

Accounting for the demerger and other disposals

To give a clearer picture of the ongoing business, we show the results of Automotive and other disposals in a separate column in the Profit and Loss Account. By identifying the interest and tax related to these activities we show clearly the EPS attributable to the ongoing activities. Interest has been attributed to the disposals on the basis of cash received on demerger or sale.

Exceptional costs

With the scale of these transactions and subsequent restructuring, we incurred significant exceptional costs. The table below identifies items involving cash – as opposed to gains or losses on sales of businesses:

Cash exceptionals

	2001 £m
Merger costs	54
Restructuring:	
Aerospace and Seals	72
Head Office	44
Automotive	18
Total before tax	188
Tax	(38)
Net cash exceptionals	150

In addition to the 'cash exceptionals' goodwill which had previously been written-off direct to reserves was charged through the P&L account. This gave rise to a loss on disposal of Automotive of £299m and a provision of £125m in respect of prospective disposals of various EIS and Air Movement businesses. The final element to the exceptional items was the £13m profit recorded on disposals other than Automotive.

Ongoing Profit and Loss

Last year, Smiths Industries reported both sales and operating profits increasing by 11%. In the first year of the new combined Smiths Group, we show ongoing sales and profits both rising by 13%.

	2001 £m	2000 £m	Change
Sales	3,466	3,062	13%
Operating profit	525	465	13%

With sales and profits increasing at similar rates, margins were static at 15%.

Current year acquisitions contributed £9m to the profit growth.

Interest was markedly higher, largely because of the acquisition spend during the 2000 year. Pre-tax profits increased by 5% and EPS by 6%, helped by a lower tax charge at 29%.

The factors behind this performance are detailed in the Chief Executive's and Business Reviews. The following paragraphs give further financial insights.

Geographic spread and exchange rates

The geographic spread of our ongoing operations is shown below:

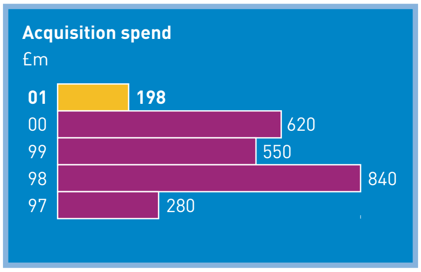
	Sales	Profit
UK	30%	25%
US	45%	52%
Continental Europe	17%	15%
Rest of the World	8%	8%

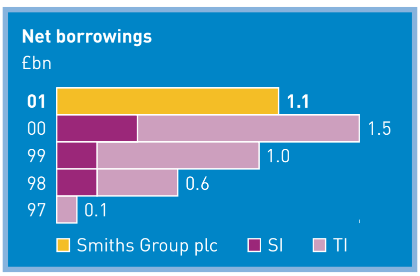
The US Dollar strengthened against sterling by 8%, while the Euro weakened by 2%. Together these exchange rates give a *translation* gain and a *transaction* loss. This year, the transaction loss arises mainly on our exports from the US. Valued at £280m, these suffered losses against most currencies in the 8% to 10% range. The economic cost of about £18m closely matches the overall translation gain of £17m.

Strong cash-flow leads to growth

In his review, the Chief Executive emphasises the importance of our strong cash generation.

This focus on cash generation extends throughout the enlarged group, and our five-year 'free cash' generation is in excess of £1bn. This is the balance left over from our profits after funding capital expenditure, working capital, interest and tax – but before acquisitions





or dividends. For Smiths, the link between cash generation and growth has long been a key element of our strategy. Our ability to generate cash is a valuable extra mechanism for growth, over and above the growth achieved by our businesses. We add to our growth by reinvesting this cash-flow in acquisitions in our chosen specialist sectors. The extent to which we fund acquisitions from internally generated cash is an important distinguishing feature of Smiths.

Acquisitions

Acquisitions have contributed much to our growth in recent years, particularly in Aerospace, Medical, Interconnect and Polymer activities.

2001 has been a year of consolidation, and our relatively modest acquisition spend of £198m was less than our free cash-flow. There are two reasons for this. First, management effort was firmly focused on the merger, the Automotive demerger and related restructuring. Second, with turbulent markets in some sectors – particularly Interconnect – the balance of advantage lay in deferring purchases until market conditions stabilised. The spend comprised £166m on new acquisitions plus £32m deferred consideration from prior year acquisitions, principally Automotive.

Cash-flow

Our management approach is geared to maximising the benefits of businesses that are naturally highly cash generative. We monitor the correlation between profit and cash generation, and expect only a small proportion of the cash from profits to be absorbed into funding additional balance sheet assets.

We measure this both at the operating level – pre-interest and tax – and at the free cash level.

The table below shows cash-flow for both total group and the continuing businesses:

	2001	
£m	Continuing	Total
Operating profit	525	648
Depreciation	91	140
Working capital	(86)	(87)
Cash-flow from operating activities	530	701
Capital spend (net)	(111)	(188)
Operating cash-flow after capex	419	513
Tax and interest	(208)	(233)
Free cash-flow	211	280
Exceptionals		(128)
Dividends		(171)
Acquisitions		(198)
Disposals		605
Other		(42)
Net cash-flow		346

The cash dividend incorporates the £61m special dividend paid to TI shareholders as part of the merger agreement.

Net borrowings at year-end were £1,120m, down from £1,466m at the beginning of the year.

Restructuring benefits

By integrating Head Offices, we have been able to vacate the Abingdon, Central London and New York offices. The annualised cost reduction is £20m, with 2001 showing a part-year benefit.

The integration of the two Aerospace businesses into a single division is also under way, as is the integration of the two previously separate parts of the new Sealing Solutions division.

A YEAR OF INTENSE ACTIVITY…WE COMPLETED THE MERGER AND ENHANCED OUR PROSPECTS BY TAKING STEPS TO CAPTURE THE BENEFITS OF SCALE AND REDUCE THE COST BASE.

Altogether 2001 benefited by £15m and we are on track to achieve our £80m target savings from 2003 onwards.

Automotive transaction

Having announced on 14 March 2001 our intention to demerge the Automotive Systems division, we successfully concluded this on 3 July 2001. Smiths Group received £615m in cash, before costs.

After this demerger we hold £325m in preference shares and 19.99% of the ordinary equity in the new TI Automotive Limited. The preference shares earn an annual 15% dividend, of which 5% is receivable annually in cash starting in July 2002, provided that TI Automotive Limited meets certain financial conditions.

TI Automotive Limited is now an independent business and from 3 July 2001 is not consolidated with the Smiths Group. Our reduced holding will be held under the net investment method of accounting. The demerger was approved by both our shareholders and former TI Group plc shareholders (through their letters of continuing entitlement) and supported by our core banking group. This was described in the press as an 'elegant solution' for maximising shareholder value.

Cost of capital and return on investment

The company's cost of capital reflects the proportions of debt and equity finance, the general level of long-term interest rates, and the degree of volatility in the share price relative to market prices generally.

The weighted average cost of capital is now 8%.

The after-tax return (pre-exceptionals) on average shareholder investment is 12%, including goodwill.

Financial controls

While our decentralised organisation delegates day-to-day control to local management, we have comprehensive budgetary control systems in place, with regular reporting to the Board.

The internal audit department reports to the Audit Committee, and reviews all key business units over a rolling three-year cycle. Acquisitions are reviewed within 12 months of acquisition, to verify compliance with the company's procedures.

Taxation

The tax charge for the year represented an effective tax rate of 29% on profits before taxation on ongoing businesses and before exceptional items and goodwill amortisation (2000 30.6%). This is the lowest effective tax rate for the combined Smiths Group for over ten years. A reconciliation of the tax charge is shown in note 9 to the Accounts.

Although we have not adopted FRS19 – Accounting for Deferred Taxation – this year (as some aspects of the application of the Standard are subject to debate), we have made steps towards complying with the required disclosures of the Standard before full adoption, as required next year. We do not anticipate the adoption of the Standard will have a material impact on our annual results.

Financing and treasury

Smiths Group operates a centralised treasury system to manage the financial risks of the group. The objectives of our treasury function are to manage the liquidity needs of the businesses cost-effectively, to provide appropriate funding for supporting capital expenditure (including business acquisitions) and to protect the group from the effect of foreign currency and interest rate fluctuations.

These objectives are achieved through detailed treasury policies approved by the Board, and compliance with these is reported annually to the Audit Committee. The strong financial disciplines and lower than average business risks in the Smiths Group were recognised by both Standard & Poors and Moody's credit ratings agencies when – following the merger – they aligned the credit rating for the group at A- and A3 respectively.

The treasury function provides services to the group within a strong control environment. Derivative financial instruments are used in specific hedging circumstances and any trading or speculating is strictly prohibited.

Borrowings: Our funding requirements are largely driven by acquisition activity and met by centrally arranged debt finance. This is lent through to the relevant subsidiary on inter-company loans at commercial arm's length terms. Our strong cash generation in the businesses is tax-efficiently remitted to the UK to repay central borrowings. Local working capital needs and capital expenditure requirements are typically funded by local bank facilities, which are not guaranteed by the parent company.

The borrowings in the former TI Group increased rapidly in recent years through extensive acquisitions. Since the merger, debt has been greatly reduced from £1.76bn at the time of merger to £1.12bn at the year-end.

Shortly after the year-end, the two TI Group syndicated loans were integrated into a single Smiths Group facility of £500m, with all major bank borrowings now drawn by Smiths Group plc.

The current net debt level of £1.12bn represents four times free cash-flow, and 'ongoing' EBITDA interest cover is more than eight times – comfortably within credit rating parameters. Our average interest cost in the year was nearly 7%, due to a large proportion of the TI Group debt being fixed. We have taken action to ensure that, going forward, we will benefit from the current low level of global interest rates. We seek to keep our debt broadly evenly split between fixed and floating rate funds, as demonstrated in note 22 to the Accounts.

Liquidity: Cash in hand at year-end was £117m and is available for redeployment within the group. Borrowings are evenly balanced between listed debt and bank facilities.

Our new Smiths Group syndicated bank facility of £500m runs until 2004. US private placements provide $160m of finance, with $100m repayable in 2002 and $60m by 2003. In addition to these facilities, we have £236m committed but undrawn credit lines. The maturity profile of our bonds is well spread, maturing in 2005, 2010 and 2016.

Currency: All material cross-border trading contracts or forecast commitments are hedged at inception by appropriate derivative financial instruments, with our core banks as counterparties. We take competitive quotes on all major foreign exchange contracts through our central foreign exchange programme. For smaller deals, we have centralised the entire group's foreign exchange dealings through a foreign exchange trading system based on the internet and operated by a major bank.

We protect our reserves from foreign currency fluctuation by ensuring that at least 75% of the total net overseas operational assets are offset, either by borrowings in the respective currency or by currency swaps. We do not hedge the translation of our overseas profits, although we mitigate currency effects through our foreign interest costs and by applying average exchange rates for the year.

Pensions

The company's principal pension schemes are in the UK and the US. The most recent actuarial valuations for the principal schemes were April 1999 and March 1998 in the UK and July 2000 and December 2000 in the US. In aggregate at these dates, assets exceeded liabilities by 19%.

The company calculates pension expense under SSAP24. The surplus is amortised over the members' estimated remaining working lives, reducing the company's pension cost.

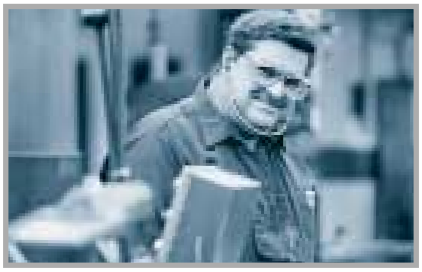
All pension and post-retirement healthcare plans have additionally been actuarially reviewed at July 2001 under the new FRS17 methodology. Note 12 fully discloses the funding position, with an overall surplus of £319m. In 2002 the full effect of FRS17 will be shown as a note, and this accounting treatment will replace SSAP24 in 2003. The greatest effect is presentational, with operating profit bearing the full cost of pensions as if there were no surplus. The benefit of the surplus will be shown as a financing gain adjacent to interest in the Profit and Loss Account.

The main pension schemes have matched their liabilities with substantial bond holdings. As a consequence, the schemes are less affected by falls in the equity market and/or interest rates than is generally the case, which gives the Profit and Loss charge some protection against volatility.

Accounting Standards

During the year FRS18 (Accounting Policies) came into force. The Group's accounting policies complied with FRS18 without change. The Group has made the new disclosures required by FRS17 (Retirement Benefits). Next year FRS19 (Deferred Taxation) will be in force. As already explained we have made steps towards the required disclosures.

Alan Thomson
Financial Director



37,700 EMPLOYEES

THE DRIVE IN MANY OF OUR PEOPLE-MANAGEMENT PROGRAMMES IS TO CHAMPION HIGHLY-CAPABLE INDIVIDUALS AND TEAMS

Managing people across a global business demands that we maximise the value of talent pools at every level in the company by unleashing their full potential. By adopting smarter working practices in lean operations, we are ensuring that knowledge and key skills are retained and managed to the best commercial advantage of the company.

Last year proved to be a tremendously exciting challenge as the numbers of employees in Smiths grew from around 17,000 to 37,700 worldwide through merger and acquisition activity. While some 75% of our employees are based in the UK and North America, we have seen a significant increase in our workforce elsewhere in the world, with large concentrations in Mexico, Malta, the Czech Republic and the Far East. To reflect this internationalisation, we have conducted a review of how we develop, recognise, motivate, communicate and reward our workforces throughout Smiths. The dramatic growth has also brought us a greatly expanded pool of highly talented people in every area of our operation. Our priority is now to enable as many as possible of these high calibre individuals to achieve their full potential and bring long-term benefits to Smiths.

With the multicultural, global nature of our business, the drive in many of our people management programmes is to identify and champion highly capable individuals and teams. The programmes focus on encouraging managers to think and act from an international perspective, and to operate outside their functional disciplines. It is key to the success of our management style in Smiths that we empower managers to take a more entrepreneurial outlook on the business challenges that face them in an increasingly competitive global marketplace. We have just completed the second year of our Management Development Programme 'Managing for Growth' with Babson College, Massachusetts. This programme helps to stimulate organic growth by promoting ideas and building entrepreneurial skills across the company. It draws together high-potential employees from different divisions and nationalities to work on real business ideas – creating sound business plans and taking them through to implementation stage.

In addition to the immense development value for participants, these real-time projects can make a visible difference to the bottom line. We believe that the concept behind these projects will increase the drive for organic growth, which is being led by our Chief Executive.

Succession management

Succession management is fundamental to our future business performance, and in particular to developing employees for worldwide roles. By refining our succession management techniques, we are assisting line managers in thinking and planning well in advance to ensure that we have innovative, entrepreneurial and culturally aware leaders in the years ahead. The importance of having the right people in the right jobs at the right time is escalating as companies strive to retain the best talent in their organisations. We firmly believe that time spent planning the future leadership of the company is vital to our continued strong growth. More effort has been focused on leadership training, which is seen as a critical success factor in training and developing top talent. At Smiths we aspire to offer people exciting, interesting and dynamic careers – not just a job.

Young talent

As a company working at the leading edge of technology, young talent is our strength for the future, and at the corporate level we support the work of individual businesses in Smiths to attract and retain good people. This year we have doubled the size of our graduate programme, ensuring that more young people have the opportunity to demonstrate their potential at an early stage in their careers. Through our continued support for programmes like Year in Industry we provide opportunities for young people – either before starting their university career or as part of their course programme – to work in Smiths on specific projects.

Our experience demonstrates that work placement offers an excellent base for recruitment, especially of apprentices and graduates, and gives young people a realistic and exciting window into a future career with the company. Many of our businesses have active partnerships with local schools and colleges to encourage young people to take up opportunities in this challenging, technologically driven company.

We have also been successful with other forms of development, including graduate secondments to other countries and tertiary educational opportunities such as the inter-company MBA programme through Henley Management College. We have also started work on the development of a new graduate website, which our own current graduates will help to create.

Mentoring

Our mentoring programme has been very valuable in supporting succession-planning efforts and helping us meet the challenge of opening the way for capable people from diverse ethnic and cultural backgrounds to succeed in Smiths. This year we are extending the programme to target specific groups such as graduates and young engineers aiming for charter status in their chosen disciplines.

Lean initiatives

Active training and development programmes operate in our businesses worldwide, and include a well-established commitment to vocational training in a wide variety of skill areas. As most of our companies move towards lean manufacturing, there is intense focus on training that supports the lean initiatives by ensuring that every employee understands the job they are expected to do and the contribution they make to the company's success. By focusing effectively and working in smarter ways, employees can ensure they enjoy an interesting job and add value to Smiths. Lean initiatives featured in our European Communication Forum discussions in Lille this year, and delegates have taken the opportunity of familiarising themselves with best practice in Smiths. We have encouraged their visits within the company, and on sites where we have recognised trade unions they are also an important element of that partnership. In a highly technology orientated company such as Smiths, it is essential for us to retain the key skills and experience to fuel our future growth. This is a clear message that all employees understand: it makes for more knowledgeable, better-motivated, and better-rewarded employees – wherever they work in the company.

Dignity at work

Throughout our businesses we have standardised our approach to human resources policies and practices to ensure that all employees receive fair and equal treatment, and that every employee is afforded dignity at work wherever in the group they are based. Respect

SAFETY CULTURE

WE BELIEVE THAT BETTER MANAGED COMPANIES VIEW SAFETY AS A LINE-MANAGEMENT RESPONSIBILITY

for each other in the workplace is a cornerstone of our business success and gives employees pride in working for Smiths.

Health and safety

Our corporate management procedures are designed to promote health and safety (H&S) as a business issue rather than simply a compliance issue, and this fully supports the company-wide lean manufacturing initiative.

The Chief Executive, Keith Butler-Wheelhouse, has taken the role of Health and Safety director, through the director, Human Resources – in line with a UK government recommendation – and will keep the company's Board fully informed of all current H&S aspects. We have also appointed a Health and Safety manager for North America to our corporate H&S staff – gaining valuable new insights into corporate H&S management from his previous experience in risk management with a major insurance broker.

Policies and practices

The Smiths Group Policy Statement for Health and Safety was revised in April to incorporate a commitment to continuous improvement and make it truly global. Signed by the Chief Executive and distributed to all the subsidiary businesses through the group managing directors, its implementation will be monitored as part of the forthcoming internal audit programme.

Internal working groups, set up through the safety conferences, represent all sectors of the Smiths Group, with members from Portex, Aerospace (Cheltenham) and Vent-Axia as well as the newer businesses Hamble Group, John Crane and Dowty Engineered Seals. These groups are investigating the implications of new standards, UK government initiatives such as 'Revitalising Health and Safety' and 'Securing Health Together', and of our initial audit findings during the year. The results were collated under four headings:

- 'People' issues, which has generated a series of reviews to ensure that HR and H&S policies are compatible in areas of overlap such as induction training.
- Occupational health issues including such hazards as stress, vibration, non-ionising radiations and musculoskeletal disorders from repetitive motion tasks.
- Changes needed for us to achieve certification under the emerging world-wide standard OHSAS 18001.
- Auditing activities, largely concerned with arrangements for the imminent move to internal auditing within each of our businesses.

Where appropriate, findings and recommendations from the on-going work of these groups is being translated into template procedures for the Smiths Best Practice Safety Manual

Procedures and controls

We will be able to update procedures quickly and easily when the Safety Manual becomes available on the Web later in the year, which will reduce administrative effort while ensuring the latest version is always to hand for employees.

Since they began in 1998, the corporate-led status reviews – or 'external' audits – of the H&S management systems in each business have helped raise awareness at all levels. We have achieved this through regular reporting of audit scores for all the subsidiary companies to the Board and to all site-based managing directors and/or Presidents. With the expansion of the group, we have brought forward plans to introduce internal auditing to meet our new H&S Policy. Trials of suitable auditing software have involved eight UK businesses from all four operating divisions. These have been very successful and we plan a roll-out to all businesses over the next 12–18 months. This system will provide the tools for our businesses to identify and track corrective actions through to completion, allowing information to be gathered locally and consolidated centrally for the benefit of both the businesses and corporate headquarters.

Accidents and injuries

While extending our data collection arrangements on accidents and absence across the whole group, we are developing a web-based system with automatic prompts designed to improve accuracy and efficiency by generating more responses with less operator involvement

Measured against comparable member companies in the SHEiiBA benchmarking association, Smiths reportable accident incident rate in the UK for 2000 was 112, the lowest recorded where the highest was 3,926. Whilst this is a good performance, we will continue

ISO 14001

THE TARGET IS FOR ALL MAJOR MANUFACTURING FACILITIES TO ACHIEVE ISO 14001 CERTIFICATION BY THE END OF 2003

to strive for even lower figures by driving down the incident rate for all accidents.

Communication

Inside and outside of the company, our reporting and consultation on H&S is regular and thorough. We publish a separate H&S Report in parallel with the Annual Report and Accounts and internally provide quarterly reports to the Board, backed by regular visits to the major sites. We also maintain contact with the individual businesses through three safety conferences a year in the UK; an annual communication forum in Europe; and annual HR and Risk Management conferences in North America. In addition, we regularly update the quarterly HR Consultative Committee on H&S issues.

Management systems

The emergence of an integrated management system to cover environment, H&S and possibly quality assurance as well has moved forward with the publication of

ISO 9000:2000 because this standard now aligns exactly with OHSAS 18001 and ISO 14001 – the international standard for environmental management systems. This should allow us to amalgamate some procedures and eliminate duplication. At a suitable time we will extend our own working group on OHSAS 18001 to include environmental managers – reducing overlap and optimising the use of our resources.

In the coming year, for the first time, all our businesses will be advised of the planned programme of projects for the 2001-2002 fiscal year. We strongly believe that better-managed companies view safety as a line-management responsibility and generally have a better safety record as a consequence. Our plan is to continue measuring performance through auditing and the achievement of previously agreed targets. This, together with increased publicity and involvement of all employees and managers, is designed to make H&S a part of the everyday management programme for all our businesses.

Environment

The Chief Executive continues to have overall responsibility for environmental performance, with the Board being briefed annually by the Director, Human Resources, on progress in the group's environmental programme.

Audit programme and performance measurement

We measure up well against objectives described in last year's Report and Accounts. For example, in line with our aims of setting reduction targets for aspects of environmental performance by 2002, we expect to sign up to the UK government's Making a Corporate Commitment Campaign by the end of 2001. Also, we successfully introduced a system of environmental metrics last year to enable us to measure performance in many areas – including environmental expenditure/cost savings, greenhouse gas emissions, water, waste, energy, and hazardous substances. We are now upgrading this for reissue at the end of 2001, and extending it to cover businesses acquired during the year.

Our group Environmental Manager and an external consultancy completed the site audits scheduled for the year – starting with the major European businesses and extending to North American facilities. This brings the number of such audits to more than 70 over the past two years. Action plans have been developed for each facility audited and a database is maintained to track the implementation of these actions. During this programme, we also piloted our new company Environmental Standards to meet our objective of establishing controls and best practice in environmental management in 2001.

Working towards our goal of improving environmental awareness and knowledge of company staff, 21 environmental co-ordinators completed a certified foundation course in environmental management, and 12 product designers took part in a workshop examining the implications on our business of European product take-back and recycling legislation.

Sharing best practice and attaining ISO 14001

We continue to develop our culture of sharing best practice through conferences, training events, demonstration projects and site visits. At our Environment Conference, directors, managers and other staff from UK businesses generated ideas for shaping environmental management to meet the demands of our global operations, and these will be explored further in future events.

We also set up two, 18 month demonstration projects geared to collective learning and developing common approaches to implementing ISO 14001 and to minimising waste. Each involves five companies, and the waste minimisation project includes two of our largest consumers of energy in the UK, Smiths Aerospace at Cheltenham and Smiths Medical (Portex) at Hythe. With some 28% of our manufacturing sites certified under ISO 14001, our enlarged organisation now has considerable experience and materials to share across the group. This will help us to reach our target of all our major manufacturing facilities achieving certification to ISO 14001 by the end of 2003. To date, 36 businesses worldwide have achieved ISO 14001 certification.

Product stewardship

We continue to integrate environmental considerations with product development. For example, we are working to reduce fugitive emissions in the process industries through sealing solutions; we have developed fuel-saving on-board systems for aircraft (such as the Queen's Award-winning Electrical Load Management System) and energy-efficient fans from Vent-Axia (Lo-Watt range). Within our Industrial activities, the Interconnect businesses are researching options for phasing out the use of lead (in solder and elsewhere) ahead of European Union Directives. However, we recognise that these are merely first steps, and will undertake further work to spread such initiatives more widely.

Future commitments

In addition to the on-going programmes described above, we are taking a number of important steps to improve environmental management capability across the group and communicate our achievements.

One important aim is to have web-based resources for environmental management in place by the end of 2001, after which we will continue to develop and update the information in line with changes in legislation, technology, and know-how. In the light of this year's audit findings, we are also revising the company Environmental Standards for the year ahead, and providing a package of ISO 14001 support measures for businesses – including training, advice, and the sharing of tools and approaches to implementing the standard. By 2003 we will have sufficient consistent data to be able to publish an environmental report for the group.

Positive force for success

We see our progress in each of these areas – human resources, H&S, and environmental issues – as a positive force for commercial success, and the integration of best practice into everyday operations is gaining momentum. In particular, we are meeting the challenge of our global dimension with a strong focus on retaining and managing knowledge and key skills. This includes the international succession-planning programme through which we will benefit fully from developing the talents and entrepreneurial outlook of high-calibre people within the group.

>BOARD OF DIRECTORS

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01 Keith Orrell-Jones
Chairman*†
Aged 64, British. He was appointed to the Board in December 1992, becoming non-executive Chairman in November 1998. He is non-executive Chairman of FKI plc and was formerly Group Chief Executive of Blue Circle Industries PLC.

Chairman of the Nominations & Remuneration Committee.

02 Keith Butler-Wheelhouse
Chief Executive
Aged 55, British. He was appointed to the Board in August 1996 and became Chief Executive in November 1996. He was previously President and Chief Executive Officer of Saab Automobile in Sweden and prior to that had been Chairman and Chief Executive of Delta Motor Corporation in South Africa. He is a non-executive director of that company and of J Sainsbury plc.

03 Robert O'Leary
Non-executive Director*†
Aged 57, US citizen. He was appointed to the Board as a non-executive director in September 1997. He is former Chairman and Chief Executive Officer of Premier Inc. and was Chairman and Chief Executive Officer of American Medical International. He is a member of the Board of Thermo Electron Corporation.

04 Sir Nigel Broomfield, KCMG
Non-executive Director*†
Aged 64, British. He was appointed to the Board in December 2000 having been a non-executive director of TI Group since 1998. Director of the Ditchley Foundation, he is an adviser to Arthur Andersen and a Trustee of the Dresden Trust. Transferred from the Army to the Foreign Service in 1968 and his last post was British Ambassador to the Federal Republic of Germany from 1993-97.

05 John Ferrie
Group Managing Director, Aerospace
Aged 54, British. He was appointed to the Board in April 2000 and became Group Managing Director, Aerospace, in August 2000. He had held a number of senior appointments in Rolls-Royce since 1964, most recently executive Vice-President, business operations, Rolls-Royce Allison. He completed an Engineering Doctorate in 1998 and is a Fellow of the Royal Academy of Engineering.

09 Lawrence Kinet
Group Managing Director, Medical
Aged 54, US citizen. He was appointed to the Board in February 2000 and became Group Managing Director, Medical in August 2000. He was previously Chairman, President and Chief Executive Officer of Aksys Ltd, and prior to that held senior appointments with Oculon Corp, Kensington Group and Baxter International Inc.

10 Alan Thomson
Financial Director
Aged 55, British. He was appointed to the Board as Financial Director on joining the company in April 1995. He was previously Finance Director of Rugby Group plc and prior to that had worked for Courtaulds plc, Rockwell International Corporation and Raychem Ltd.

11 Julian Horn-Smith
Non-executive Director*†
Aged 52, British. He was appointed to the Board as a non-executive director in February 2000. He is Chief Operating Officer of Vodafone Group Plc, a director of several of its European operating companies, and is Chairman of the Management Board of Mannesmann AG.

06  07  08 

12  13 

06 John Hignett.
Non-executive Director*†
Aged 67, British. He was appointed to the Board in December 2000 having been a non-executive director of TI Group since 1989 and Deputy Chairman from 1993-2000. He is Chairman of Schroder Income Growth Fund plc. He was formerly a Managing Director of Lazard Brothers & Co. Ltd, Director General of the Takeover Panel and Finance Director of Glaxo Holdings plc.

07 David Lillycrop
General Counsel
Aged 45, British. He was appointed to the Board in December 2000, having been an executive director of TI Group since June 1998. He joined TI Group in 1989, becoming Group Company Secretary in 1991 and, additionally, General Counsel in 1997. A barrister, he was previously Director of Legal Affairs at Quaker Oats Ltd. He is Chairman of TI Pension Trustee Ltd.

08 Sir Colin Chandler
Non-executive Deputy Chairman*†
Aged 61, British. He was appointed to the Board in December 2000; a non-executive director of TI Group since 1992. He is Chairman of Vickers Defence Systems and was formerly Chairman of Vickers plc. He worked for British Aerospace and, on secondment, became Head of Defence Export Services, MoD. He was Chairman of Racal Electronics and is a non-executive director of Thales plc.

Chairman of the Audit Committee.

12 John Langston
Group Managing Director, Sealing Solutions
Aged 51, British. He was appointed to the Board in December 2000, having been a director of TI Group and Chief Executive of TI Specialty Polymer Products, since October 1998. He joined TI Group in 1993, becoming Chief Executive of Bundy Automotive in 1997. He was formerly General Manager of the European Car Braking Division of Lucas.

13 Einar Lindh
Group Managing Director, Industrial
Aged 56, British. He was appointed to the Board, as head of the Industrial business, in February 1996. He first joined the company in 1973, leaving in 1979 to take up an appointment at Great Universal Stores plc. He returned to Smiths in 1983, becoming Managing Director of Portex Ltd in 1990. He is a non-executive director of Spirax Sarco Engineering plc.

*Audit Committee
†Nominations & Remuneration Committee

>DIRECTORS' REPORT

Principal activities
The principal activities of the company and its subsidiaries are the development, manufacture, sale and support of:

– integrated aerospace systems, including electronic and actuation systems and precision components, for civil and military aircraft. Also equipment for land, naval and marine and other defence applications, including detection and protection against chemical and biological agents;

– mechanical and polymer seals used in industries ranging from petrochemical processing to aerospace, plus complete marine propulsion systems;

– medical devices and critical care equipment aligned to specific therapies, principally airway, pain and temperature management and infusion. Also needle protection, critical care monitoring, women's healthcare, and vascular access;

– interconnect products to connect and protect safety-critical electrical and electronic equipment, and air movement systems and components.

The main manufacturing operations are in the UK, the Americas and Continental Europe. A review of the development of the company and its subsidiary undertakings during the 2000-2001 financial year is contained in pages 18 to 30.

Results and dividends
The results for the year to 31 July 2001 are set out in the Consolidated Profit and Loss Account on page 48. Sales for the year amounted to £4,958m, against £4,653m last year. The loss for the year after taxation, minority interests and goodwill amortisation amounted to £206.0m (2000 profit of £324.0m).

An interim dividend of 8.75p per ordinary share of 25p was paid on 18 May 2001. The directors recommend for payment on 16 November 2001 a final cash dividend on each ordinary share of 16.25p, making a total dividend of 25p for the year.

The retained loss of £405.5m was transferred to Reserves.

Research and development
£188m was spent on research and development for continuing activities during the year, of which £91m was funded by the company and the balance by customers. Each business carries out research and development programmes to suit its own particular market and product needs. Interchange of technology and technical information between businesses in the manufacturing sector is centrally co-ordinated.

Changes in the company and its interests during the year
On 30 October 2000 Smiths Aerospace, Inc. acquired the business and assets of the Fairchild Defense division of Orbital Sciences Corp. for £75m in cash.

On 30 November 2000 the company changed its name to Smiths Group plc.

On 4 December 2000 the company merged with TI Group plc. Under the terms of the merger there were issued to TI shareholders 233,604,697 new Smiths Group plc shares and 507,836,299 units under letters of contingent entitlement. TI shareholders on the register of shareholders on 1 December 2000 also received a special dividend of 12p per TI share. During the period 4 December 2000 to 6 June 2001, a further 945,358 new shares and 2,055,328 units under letters of contingent entitlement were issued in exchange for 2,055,328 new TI shares issued on the exercise of employee share options.

On 15 December 2000 SI US Finance Inc. sold all the issued share capital of Lambda Advanced Analog, Inc. to International Rectifier Corporation for US$17m in cash.

On 18 December 2000 Smiths Group North America, Inc. bought the issued share capital of Radio Waves, Inc. for £17m in cash.

On 13 March 2001 Smiths Group plc sold all the issued share capital of Smiths Industries Hydraulics Company Limited to SPX Corporation for £12m in cash.

On 31 March 2001 Smiths Industries Australia Pty Limited bought the business and assets of Chapman Avionics for A$3.4m in cash.

On 11 May 2001 Smiths Aerospace, Inc. bought the issued share capital of Barringer Technologies, Inc. and its subsidiary companies for £39m in cash.

On 30 June 2001 the company sold the issued share capitals of Eschmann Bros and Walsh Limited and SIMS Pte Ltd (Singapore) to a private group of investors for £11m in cash.

On 3 July 2001 the businesses and assets of the Automotive Systems division were demerged into a new, private company, named TI Automotive Limited. The holders of units under letters of contingent entitlement exchanged their units for A Ordinary shares in TI Automotive Limited on a one-for-one basis. Smiths Group plc received £615m in cash, 325,000,000 preference shares and 185,288,740 B Ordinary shares in TI Automotive Limited.

Post balance sheet events
On 10 September 2001 EIS Group PLC sold its fluid handling business, Plenty Group, comprising the assets of GSF Europe BV; Plenty Products, Inc.; Plenty India Limited; Plenty Uniquip Pty Limited and the majority of Plenty Limited, to SPX Lightnin for £11m in cash.

On 14 September 2001 Smiths Industries B.V. sold all the issued share capitals of Induplas SpA and Flexiplas S.A. and Smiths Industries Industrial Group Limited sold the EuroHose business to A.G. Petzetakis S.A. for €12.55m in cash.

Future developments
The company will pursue its existing international activities and continue to seek business opportunities in both the UK and overseas.

Charitable and political donations
During the year the company made donations of £730,000 for charitable purposes including payments totalling £297,000 for the Portex Chair of Paediatric Anaesthesia. No political donations were made.

Directors
The names of those who were directors at the end of the financial year are listed on pages 36 and 37.

On 31 July 2000 Mr N V Barber retired as an executive director. Mr G M Kennedy retired as an executive director on 4 August 2000. Mr A I H Pink resigned as a non-executive director on 26 September 2000. Mr Pink's subsequent death was mentioned in the interim report. Mr R F Leverton retired as a non-executive director at the Annual General Meeting on 14 November 2000; and Mr P T Hollins resigned as a non-executive director on 3 December 2000.

Sir Colin Chandler, Sir Nigel Broomfield and Mr J M Hignett were appointed as non-executive directors and Messrs J Langston and D P Lillycrop were appointed as executive directors as part of the merger with TI Group plc. Their appointments took effect on 4 December 2000.

Re-appointment of directors

Mr E Lindh and Mr A M Thomson will retire by rotation, in accordance with Articles 73 and 74 and, being eligible, will seek re-appointment at the Annual General Meeting. Sir Colin Chandler, Sir Nigel Broomfield, Mr Hignett, Mr Langston and Mr Lillycrop will retire at the Annual General Meeting, following their appointment during the year, and, being eligible, seek re-appointment.

Directors' interests in contracts

Details of executive directors' service contracts are as disclosed in the Contract Terms section of the report of the Nominations and Remuneration Committee on page 42. Details of the interests of the executive directors in the company's share option schemes are shown on page 46.

Sir Colin Chandler, Sir Nigel Broomfield and Messrs Hignett, Langston and Lillycrop were directors of and shareholders in and, in the case of Messrs Langston and Lillycrop, holders of options over the shares of, TI Group plc at the time of the merger of TI Group with the company. They were also interested, as holders of units under letters of contingent entitlement, in the demerger of the Automotive Systems division.

With the exceptions referred to above, no director had an interest in any contract to which the company or its subsidiaries was a party during the year.

Interests in shares

As at 25 September 2001 the company had been notified, pursuant to the Companies Act 1985, of the following material or notifiable interests in its issued share capital:

	No. of shares	Percentage† of issued capital
The Capital Group Companies, Inc*	66.6m	12.0%

*includes the interests of Capital Guardian Trust Company in 7.2% of the issued share capital
†percentage of share capital in issue on 25 September 2001.

The interests of the directors, their families and any connected persons in the issued share capital of the company are shown on page 45.

Corporate Governance

The company complies with the Combined Code, as defined in the Listing Rules of the UK Listing Authority, (the 'Code'), except that no senior independent director is recognised as required by A.2.1 of the Code.

Subject to that exception, the company has complied with the Code throughout the accounting period covered by this Report. Reasons for non-compliance with A.2.1 are given below.

The Board of Directors normally meets formally eight times a year to make and review major business decisions and monitor current trading against budgets which it has approved. It additionally exercises control by determining matters specifically reserved to it in a formal schedule which only the Board may change: these matters include the acquisition of companies and major capital expenditure. Once a year the Board meets in conference to consider long-term strategy and industrial developments affecting the company. Additional meetings are arranged as necessary to deal with urgent items.

There is an agreed procedure for all directors to take independent professional advice at the company's expense in connection with their duties. They also have access to the advice and assistance of the Company Secretary whose appointment is in accordance with the Code. Arrangements are in place for all directors to receive appropriate training, whether on their appointment or periodically, as necessary.

Mr K Orrell-Jones, who is the senior non-executive director, is the Chairman and also chairs the Nominations and Remuneration Committee. Sir Colin Chandler is the Deputy Chairman and also Chairman of the Audit Committee. No other non-executive director has been appointed as 'a recognised senior member' for the purposes of A.2.1 of the Code because matters of concern can readily be brought to the attention of either Mr Orrell-Jones or Sir Colin Chandler who have clear areas of responsibility. Mr Butler-Wheelhouse is the Chief Executive. There are now six independent non-executive directors and seven executive directors on the Board.

The Board is provided with detailed information on matters to be considered at its meetings and non-executive directors have ready access to the executive directors. Regular site visits are arranged and non-executive directors are encouraged to visit sites. During site visits, briefings are arranged and the Board is free to discuss aspects of the business with employees at all levels.

There is a formal procedure for appointment of all new directors. The Nominations and Remuneration Committee, which comprises all the non-executive directors, makes recommendations to the Board on appointments. Appointments approved by the Board are subject to confirmation by the shareholders at the next Annual General Meeting.

All directors are subject to retirement by rotation and submit themselves for re-election at intervals of no more than three years: any director who attains the age of 70 is subject to annual re-election. The initial appointment of non-executive directors is for three years: they do not participate in company bonus, share option or pension schemes.

The Nominations and Remuneration Committee meets at least three times a year. Mr Butler-Wheelhouse attends meetings of the Committee by invitation but does not participate in discussions of his own interests. The Committee monitors the performance of the Chief Executive and other executive directors and has access to all information required for that purpose. The report of the Board on executive remuneration is set out on pages 42 to 46.

The company maintains a dialogue with institutional shareholders through regular meetings and presentations. At the Annual General Meeting shareholders are encouraged to ask questions and after the meeting have access to directors and other senior executives. The company has complied with the Code provisions related to principles C.1 and C.2.

The Board believes that the Report and Accounts present a balanced and understandable assessment of the company's position and prospects: the Board has complied with the Code Provisions D.1.1 to D.1.3. A statement by the Auditors appears on page 47.

The Audit Committee's terms of reference accord with the Code. The Committee comprises all the non-executive directors and meets at least three times a year with the Chief Executive, Financial Director, General Counsel, Director of Internal Audit and the auditors normally attending meetings.

Internal control. Smiths Industries plc and TI Group plc operated as separate companies under the management of their Boards of Directors until completion of the merger on 4 December 2000. Both companies operated broadly similar processes of internal control, based on an assessment of risk and framework of control procedures to manage risks and to monitor compliance with procedures. In the case of both companies the process accorded with the guidance on internal control issued by the Turnbull Committee. Smiths Group has brought together and adopted the procedures previously operated by Smiths Industries and TI Group. The procedures of accountability and control for Smiths Group, which are consistent with those followed by Smiths Industries and TI Group, are outlined below.

The Board accepts its responsibility for maintaining and reviewing the effectiveness of the company's system of internal controls. The internal control systems are designed to meet the company's particular needs and the risks to which it is exposed, and by their nature can provide only reasonable, not absolute, assurance against material loss to the company or material misstatement in the financial accounts.

The group has an embedded process for the identification, evaluation and management of significant business risks. The process is reviewed through the Audit Committee and monitored by the group Internal Audit Department. The four operating divisions and Corporate HQ have, during the year, identified and evaluated the key risks under three categories – strategic; operational; and information – and have ensured that effective controls and procedures are in place to manage these risks.

In the highly regulated environment of the aerospace and medical industries, procedures are codified in detailed operating procedures manuals and are reinforced by regular educational programmes. This is designed to ensure not only compliance with the regulatory requirements but also with the general principles of business integrity.

A key element in any system is communication and a number of committees exist which enable the executive directors and senior corporate staff to address financial, human resource, risk management and other control issues. Experience is shared by subsidiaries through company-wide seminars.

Throughout the year the Board has reviewed the effectiveness of internal control and the management of risks at its regular board meetings. In addition to financial and business reports, the Board has reviewed medium and longer-term strategic plans; capital expenditure and development programmes; reports on key operational issues; tax; treasury; risk management; insurance; legal matters and Audit Committee reports, including internal and external auditor reports.

Going concern. The Board's review of the accounts, budgets and forward plans, together with the internal control system, lead the directors to believe that the company has ample resources to continue in operation for the foreseeable future. The accounts are therefore prepared on a going concern basis.

Auditors. PricewaterhouseCoopers have reviewed the company's statements as to compliance with the Code to the extent required by the Listing Rules of the UK Listing Authority. The results of their review are set out on page 47.

Policy on payment of creditors

The company's policy and practice is to pay creditors promptly in accordance with agreed terms of business. The average time taken to pay an invoice was 36 days for the parent company and 55 days for the group as a whole (calculated in compliance with the Companies Act 1985 (Directors' Report)(Statement of Payment Practice) Regulations 1997).

Environment

The company seeks to ensure that, as far as is reasonably practicable, any detrimental effects to the environment of its operations and products are minimised. A senior corporate staff director has responsibility for safety, health and environmental matters: three full-time managers report to that director and co-ordinate and monitor the safety, health and environmental activities of the company. A more detailed statement appears on pages 33 to 35.

Employment policies

It is the company's policy to provide equal opportunities for employment and to give the fullest consideration to employment prospects for the disabled. The company continues to be actively involved in all aspects of the training and development of young persons, including government sponsored schemes and unit initiatives designed to ease the transition from school to work.

Share option schemes enable employees to acquire an interest in the company's shares and to align their interests more closely with those of the shareholders generally.

Employees are regularly provided with a wide range of information concerning the performance and prospects of the business in which they are involved by means of Employee Councils and other similar consultative bodies which allow the views and opinions of personnel to be taken into account.

All matters concerning the environment, health and safety continue to be regulated by preventative, investigatory and consultative systems; issues relevant to the company pension scheme are likewise covered by means of structured committees, including representation from recognised trade unions. A more detailed statement appears on pages 31 to 35.

Authority to issue shares
At the Annual General Meeting shareholders will be asked to revise the authority, given to the directors at the Extraordinary General Meeting in November 2000, to allot relevant securities for the purposes of section 80 of the Companies Act 1985, so as to reflect the increase in the company's issued share capital since the Extraordinary General Meeting.
The authority proposed will expire on the fifth anniversary of the Meeting unless otherwise renewed. The amount of relevant securities to which this authority relates represents one third of the share capital in issue on 25 September 2001. The directors have no present intention of exercising this authority. The ordinary resolution is set out in the Notice of Annual General Meeting.

Also in the Notice is the special resolution to renew the power granted to directors under section 95 of the Companies Act 1985. The new authority sought will be on substantially similar terms to those attaching to the existing authority and will expire on the fifth anniversary of the Meeting, unless otherwise renewed. It will permit the directors to allot equity securities for cash:

– in connection with a rights issue pro rata to the rights of the existing shareholders;
– pursuant to the terms of any share scheme approved by the shareholders in General Meeting; and
– for any other purpose provided that the aggregate nominal value of such allotments does not exceed £6,948,618 (approximately 5% of the share capital in issue on 25 September 2001).

The directors intend seeking renewal of these authorities annually.

During the year ended 31 July 2001 the following ordinary shares in Smiths Group plc were issued:

– 234,550,055 shares to former shareholders of TI Group plc;
– 956,028 shares pursuant to the terms of the company's shareholder-approved share option schemes;
– 298,809 shares pursuant to the terms of TI Group share option schemes; and
– 2,624,134 shares under the scrip dividend share alternative scheme.

Authority to purchase shares
At the Annual General Meeting the company will seek to renew the authority, granted in general meeting on 17 November 2000 to the directors to purchase the company's shares in the market. The authority will be limited to 10% of the share capital in issue on 25 September 2001 and will be renewed annually. The maximum price that may be paid under the authority will be limited to 105% of the average of the middle market quotations of the company's shares, as derived from the London Stock Exchange Daily Official List, for the five business days prior to any purchase. On 25 September 2001 options over approximately 23.9m shares were outstanding under the company's share option schemes, representing approximately 4.3% of the then issued share capital. If the authority to purchase shares being sought at the Annual General Meeting were to be used in full, then the outstanding options would represent approximately 4.8% of the reduced issued share capital.

The directors will exercise the authority only if they are satisfied that any purchase will increase the earnings per share of the ordinary share capital in issue and will be in the interests of the shareholders. The directors will also give careful consideration to the gearing levels of the company and its general financial position.

No shares have ever been purchased or contracted for or the subject of any option under the expiring or any prior authority.

Auditors
Resolutions will be proposed at the Annual General Meeting to reappoint PricewaterhouseCoopers as auditors and to authorise the directors to determine the auditors' remuneration.

Executive Share Option Scheme
A resolution will be proposed at the Annual General Meeting to revise the company's Executive Share Option Scheme. Details of the revisions are contained in a letter from the Chairman to shareholders, dated 12 October 2001.

www.smiths-group.com
Electronic copies of these reports and accounts, the notice of Annual General Meeting and the Chairman's letter to shareholders will be posted on the company's website, www.smiths-group.com Future announcements to the Stock Exchange and press releases will be made available online through the website. Shareholding details and practical help on share transfers and changes of address can be found at www.shareview.co.uk

By Order of the Board

David P Lillycrop
Director and Secretary

5 October 2001
765 Finchley Road
London NW11 8DS

Report on Directors' remuneration

The Nominations and Remuneration Committee of the Board referred to on page 40 determines the remuneration of executive directors including their annual bonus targets and grants of share options. Its constitution and practice accord with the relevant provisions of the Combined Code, as defined in the Listing Rules of the UK Listing Authority (the Code).

The Committee seeks to maintain a competitive programme that enables the company to attract and retain the highest calibre of executive. The Committee consults with the Chief Executive and has access to external remuneration consultants, which enables wide-ranging comparisons to be made. In reviewing its remuneration policy the Committee has given full consideration to the Code and considers that there are no matters which should be submitted for approval to this year's Annual General Meeting, at which the Chairman of the Committee will be present to answer questions.

The remuneration of directors is set out in tables on pages 43 to 46.

Salaries are reviewed annually. The Committee takes into account individual performance and experience, the size and nature of the job, the relative performance of the company, pay policy within the company and the salary available in comparable companies. Benefits include a company car, pension, health insurance and, where appropriate, relocation expenses, generally in line with benefits available for executives in similar positions in other aerospace and engineering companies.

Bonuses are based on successful performance and are paid only on the achievement of carefully considered targets and objectives. All bonuses are capped. Under a deferred share scheme, established in 1992, executive directors may use their after-tax bonus to buy the company's shares at the prevailing market price; if they retain those shares for three years they may exercise options over a matching number of shares for a nominal sum. Income tax is payable on the market value of the matching shares when the option is exercised. In December 2000 executive directors participated in the scheme in respect of their 2000 bonuses and were granted options over shares as shown in a table on page 46.

The annual bonus and any gains under share option schemes are not pensionable.

Pensions. The company pays monthly salary supplements, as money purchase contributions, to some of the directors. For the other directors, final salary schemes provide a pension of up to two thirds of final pensionable salary, subject to Inland Revenue limits. Where Revenue limits apply, the difference between the pension payable on the cap and that payable on two thirds of final salary is, after taking into account any retained benefits from previous employment, provided by the company. Details of the money purchase contributions and the pension provisions are set out in the tables on page 44.

Contract terms. Five executive directors, including two directors who joined from the Board of TI Group plc at the time of the merger in December 2000, have agreed to relinquish their two-year rolling contracts and to be employed in future on terms including a one-year rolling period of notice. The remaining two executive directors, who joined the Board in February and April 2000 respectively, are already subject to one-year notice periods (after the completion of an initial two-year term). This is consistent with the company's previously stated commitment to phase out two-year contracts for all executive directors. The terms of the one-year contracts include provision for the payment of predetermined damages in the event of termination of employment in certain circumstances.The four executive directors who, as stated in the Directors' Report, are to be proposed for re-election at the AGM are employed on one-year rolling contracts.

The two TI Group directors referred to above, Mr J Langston and Mr D P Lillycrop, have also agreed to relinquish certain rights arising under their TI service agreements as a consequence of the merger. These include the right, in each case, to receive a sum of approximately £1.5m upon termination of employment in any circumstances, including termination without notice by the director concerned. In return for relinquishing these rights each of these directors has received a special payment (identified as a 'TI contract payment' in the emoluments table on page 44) of £200,000 and has become contingently entitled to receive a number of Smiths Group shares without cost on 26 September 2004 if still employed by the company on that date (or sooner in certain limited circumstances). The number of shares in question is as shown below the directors' interests table on page 45. By these means the company has secured the continued employment of these two executives.

Non-executive directors were paid a total of £341,000 (including £176,000 in fees) in the year to 31 July 2001. Their remuneration is determined by the Board within the limits set out in the articles of association. They are not eligible for bonuses or participation in share schemes and no pension contributions are made on their behalf. The non-executive directors, including those who, as stated in the Directors' Report, are to be proposed for re-election at the AGM, do not have service contracts.

Directors' interests in the company's shares

The interests of directors in the issued share capital of the company are set out in a table on page 45.

The executive share option scheme approved at the AGM in 1995 covers approximately 335 executives. Awards are approved by the Committee. In awarding share options the Committee has regard to guidelines published by investor protection committees, the individual performance of participants and any evidence that the scheme has encouraged option holders to become shareholders. Options granted under the 1995 Scheme may only be exercised after three years if a performance requirement, determined by the Committee, has been met.

Under the terms of the merger with TI Group plc and the rules of the various

TI Group share option schemes, holders of TI Group share options were able to exchange their options over TI Group shares for options over Smiths Group shares during the period ended 4 June 2001. All exchanged options remain subject to the rules of the TI Group share option scheme under which they were originally granted. Details of the exchanged options outstanding at 31 July 2001 are shown on page 69.

The Save-As-You-Earn share option scheme, which is open to all UK employees with 12 months' service, is subject to UK legislation as to the amount that can be saved. Participants save a fixed sum per month for three or five years and may use the sum generated by their savings contracts to exercise the options which are usually granted at a 20% discount to the market price.

In the year to 31 July 2001, executive directors exercised share options and at 31 July 2001 held unexercised options as described in a table on page 46. Mr Langston and Mr Lillycrop elected to exchange all their options over TI Group shares for options over Smiths Group shares on 14 March 2001. Details of their post-exchange options are shown in the table.

There were no changes in the options held by directors between 31 July 2001 and 25 September 2001. The Register of Directors' interests (which is open to inspection) contains full details of directors' shareholdings and options to subscribe for shares in the company.

Subject to the overriding requirements of the company, the Committee is prepared to allow executive directors to accept external appointments where it considers that such appointments will contribute to the directors' breadth of knowledge and experience. Directors are permitted to retain fees associated with such appointments.

Remuneration

The total remuneration of directors, excluding the value of shares to which certain directors may become entitled under the deferred share scheme (shown in the table on page 44) and also defined benefit pension arrangements, is as follows:

	2001 £000	2000 £000
Fees, salaries and benefits	**2,846**	2,244
Performance related bonuses	**1,362**	958
Gain from exercise of share options	**32**	14
Incremental gain/(loss) from deferred share scheme exercises	**12**	(2)
Money purchase pension contributions	**429**	303
TI contract payments	**400**	
	5,081	3,517

The comparative figures shown above include the remuneration of Mr N V Barber (who retired on 31 July 2000) and Mr G M Kennedy (who retired on 4 August 2000).

>DIRECTORS' EMOLUMENTS AND INTERESTS continued

The emoluments of the directors are set out below:

	Fees/Salary 2001 £000	Fees/Salary 2000 £000	Bonus 2001 £000	Benefits 2001 £000	Deferred share scheme contributions 2001 £000	Money purchase pension contributions 2001 £000	TI contract payments 2001 £000	Total 2001 £000	Proforma 2001 £000	Total 2000 £000	Proforma 2000 £000
Chairman											
K Orrell-Jones	**172**	125		**21**				**193**	**193**	137	137
Chief Executive											
K O Butler-Wheelhouse	**505**	470	**439**	**41**	**147**	**253**		**1,385**	**1,385**	1,079	1,079
Executive directors											
J Ferrie (appointed 10.4.00)	**265**	82	**184**	**126**		**106**		**681**	**681**	191	191
G M Kennedy (retired 4.8.00)	**25**	275						**25**	**25**	472	472
L H N Kinet (appointed 1.2.00)	**280**	138	**105**	**186**		**70**		**641**	**641**	253	253
J Langston (appointed 4.12.00)	**198**		**154**	**19**			**200**	**571**	**752**		437
D P Lillycrop (appointed 4.12.00)	**198**		**161**	**23**			**200**	**582**	**799**		568
E Lindh	**285**	265	**131**	**32**	**83**			**531**	**531**	487	487
A M Thomson	**275**	250	**188**	**26**	**78**			**567**	**567**	456	456
Non-executive directors											
Sir Nigel Broomfield (appointed 4.12.00)	**20**							**20**	**42**		30
Sir Colin Chandler (appointed 4.12.00)	**43**							**43**	**61**		32
J M Hignett (appointed 4.12.00)	**19**							**19**	**57**		77
P T Hollins (resigned 3.12.00)	**10**	25						**10**	**10**	25	25
J Horn-Smith (appointed 8.2.00)	**30**	13						**30**	**30**	13	13
R F Leverton (retired 14.11.00)	**12**	25						**12**	**12**	25	25
R W O'Leary	**30**	25						**30**	**30**	25	25
A I H Pink (resigned 26.9.00)	**5**	25						**5**	**5**	25	25
	2,372	1,718	**1,362**	**474**	**308**	**429**	**400**	**5,345**	**5,821**	3,188	4,332

1 The proforma emoluments shown are the emoluments for the directors listed above paid by the company during the financial year, and the prior financial year, including payments made to certain directors of TI Group plc prior to the merger; these figures are shown for illustrative purposes only. TI contract payments are described on page 42.

2 The deferred share scheme amounts represent shares to which certain directors may become entitled and relate to the previous year's bonus.

3 Benefits for Dr Ferrie and Mr Kinet include payments related to their relocation to the UK from the US.

Pensions

	Age at 31 July 2001	Directors' contributions during the year £000	Additional pension earned during the year (excluding any increase for inflation) £000	Accrued entitlement at 31 July 2001 £000
J Langston	51	3	12	90
D P Lillycrop	45	3	9	81
E Lindh	56	14	17	172
A M Thomson	54	14	21	127

An executive director's normal retirement age is 60. An early retirement pension, based on actual service completed, may be paid after age 50 and may be subject to a reduction on account of early payment. On death a spouse's pension of two-thirds of the director's pension (or for death-in-service his prospective pension at age 60) is payable. All pensions in excess of the Guaranteed Minimum Pension (GMP) are guaranteed to increase at the rate of 5% per annum compound or the annual increase in the Retail Prices Index, if less; (for Messrs Langston and Lillycrop, guaranteed increases are subject to a maximum of 7% per annum). There has, however, been a long-standing practice of granting additional discretionary increases on pensions in excess of the GMP to bring them into line with price inflation.

Messrs Langston and Lillycrop became executive directors on 4 December 2000. The figures shown for contributions and additional pension cover the period from 4 December 2000 to 31 July 2001. Prior to becoming executive directors they had already accrued pension benefits during their employment with TI Group plc; these benefits are included in the accrued entitlement at 31 July 2001.

TI Group arrangements

Mr Langston and Mr Lillycrop were participants in three-year share performance plans operated by TI Group plc prior to its merger with the company. Such participation related to three measurement periods each of which was terminated by the merger. No award was made in respect of the measurement period 1998-2001. Awards of shares were made in respect of the measurement periods 1999-2002 and 2000-2003; the total number of Smiths Group shares awarded (or, where applicable, exchanged for TI Group shares awarded) and the equivalent total cash value based on the relevant share prices at the time of award are set out below. The comparative cash value relates to awards made in May 2000 in respect of the measurement period 1997-2000. No further awards may be made under these plans.

	No. of shares	Equivalent cash value £000	1997-2000 Equivalent cash value £000
J Langston	61,388	500	47
D P Lillycrop	79,268	652	41

Four executive directors of TI Group plc at the time of the merger did not become directors of Smiths Group. Awards of shares under three-year share performance plans made to these former TI directors (on the same basis as in the table above) are set out below. In addition, contractual change of control payments made to these former directors at or shortly after the dates on which they ceased to be employed by the company, and emoluments in respect of the period from the merger until the cessation of employment, are set out below.

	Share performance plans				
	No. of shares	Equivalent cash value £000	Salary £000	Benefits £000	Change of control payments £000
M D Angle	102,189	850	–	–	1,646
W J Laule	200,540	1,661	252	15	2,336
Sir Christopher Lewinton	270,708	2,268	–	–	2,375
T A Welsh	94,511	778	135	8	1,746

Directors' interests in the company's shares

	Ordinary shares of 25p	
	31 July 2001	31 July 2000
Sir Nigel Broomfield	**103**	103*
K O Butler-Wheelhouse	**55,336**	36,542
Sir Colin Chandler	**8,778**	8,778*
J Ferrie	**0**	0
J M Hignett	**67,685**	65,767*
J M Horn-Smith	**6,682**	5,000
L H N Kinet	**0**	0
J Langston	**60,270**	50,668*
D P Lillycrop	**68,158**	64,922*
E Lindh	**33,584**	23,215
R W O'Leary	**3,315**	3,315
K Orrell-Jones	**3,226**	3,155
A M Thomson	**42,066**	28,841

* indicates share interest at appointment on 4 December 2000

These interests include beneficial interests in the company's shares held in PEPs and ISAs and holdings through nominee companies. Except as reported below, none of the directors has disclosed any non-beneficial interests in the company's shares.

Mr J Langston and Mr D P Lillycrop also both have a technical interest in 7,636,379 ordinary shares in the company as discretionary beneficiaries under the TI Group Jersey Employee Share Trust and the TI Group Employee Share Trust (the 'Trusts'). These shares may be transferred to employees who exercise options granted under the TI Group share option schemes. In addition, Mr Langston has a contingent interest in 125,000 ordinary shares, and Mr Lillycrop has a contingent interest in 100,000 ordinary shares, arising from contractual arrangements as disclosed in the Contract Terms section of the Committee's report on page 42.

The company has not been notified of any changes to the holdings of the directors, their families and any connected persons between 1 August and 25 September 2001.

Directors' share options

Director	Scheme	Options held on 31 July 2001 Number	Options held on 31 July 2000 Number	Weighted average Exercise price	Options exercised 2000-2001 Date exercised	Number	Exercise price	Market price†	Options granted 2000-2001 Date of grant	Number	Exercise price	Expiry date
K O Butler-Wheelhouse	95ESOS	392,137	291,107	823.82p					1/12/00	53,230	807.00p	1/12/10
									19/4/01	47,800	790.00p	19/4/11
	SAYE	2,578	2,578	669.00p								
	DSS	53,248	35,284	0.10p					4/12/00	17,964	0.10p	4/11/07
J Ferrie	95ESOS	130,019	55,424	783.51p					1/12/00	31,895	807.00p	1/12/10
									19/4/01	42,700	790.00p	19/4/11
	SAYE	2,775	0	608.00p					10/5/01	2,775	608.00p	1/2/07
L H N Kinet	95ESOS	135,741	59,733	776.57p					1/12/00	33,308	807.00p	1/12/10
									19/4/01	42,700	790.00p	19/4/11
	SAYE	1,593	0	608.00p					10/5/01	1,593	608.00p	1/2/05
J Langston	95ESOS	42,700	0*	790.00p					19/4/01	42,700	790.00p	19/4/11
	SAYE	1,593	0*	608.00p					10/5/01	1,593	608.00p	1/2/05
	TI (1990) ESOS	160,104	160,104**	930.61p								
	TI 1999 ESOS	258,237	258,237**	706.44p								
D P Lillycrop	95ESOS	42,700	0*	790.00p					19/4/01	42,700	790.00p	19/4/11
	TI (1990) ESOS	138,215	138,215**	992.72p								
	TI 1999 ESOS	274,223	274,223**	703.02p								
	TI SAYE	1,990	1,990**	866.58p								
E Lindh	84ESOS	8,851	16,851	451.00p	26/7/01	8,000	451.00p	756.50p				
	95ESOS	216,980	146,677	804.63p					1/12/00	40,903	807.00p	1/12/10
									19/4/01	29,400	790.00p	19/4/11
	SAYE	5,002	3,409	583.47p					10/5/01	1,593	608.00p	1/2/05
	DSS	35,602	29,880	0.10p	28/9/00	2,984	0.10p	697.00p	4/12/00	10,128	0.10p	4/11/07
					26/7/01	1,422	0.10p	748.00p				
A M Thomson	84ESOS	62,500	62,500	480.00p								
	95ESOS	179,768	121,920	801.42p					1/12/00	31,598	807.00p	1/12/10
									19/4/01	26,250	790.00p	19/4/11
	SAYE	2,775	3,015	608.00p	4/7/01	3,015	572.00p	837.00p	10/5/01	2,775	608.00p	1/2/07
	DSS	33,326	23,771	0.10p					4/12/00	9,555	0.10p	4/11/07

Key

84ESOS	The Smiths Industries (1984) Executive Share Option Scheme
95ESOS	The Smiths Industries 1995 Executive Share Option Scheme
SAYE	The Smiths Industries 1982 SAYE Share Option Scheme
DSS	The Smiths Industries Senior Executive Deferred Share Scheme
TI (1990) ESOS	The TI Group (1990) Executive Share Option Scheme
TI 1999 ESOS	The TI Group 1999 Executive Share Option Scheme
TI SAYE	The TI Group 1994 Savings-Related Share Option Scheme

* Options held at date of appointment (4 December 2000)

** Options held at date of appointment (4 December 2000) after conversion into options over Smiths Group shares on 14 March 2001

† Mid-market closing quotation from the London Stock Exchange Daily Official List or actual sale price if shares sold on date of acquisition

Notes

The high and low market prices of the ordinary shares during the period 1 August 2000 to 31 July 2001 were 984p and 632p respectively.

The mid-market price on 31 July 2000 was 915p and on 31 July 2001 was 772p.

Of the 2,060,481 shares under options granted to directors under the executive and savings-related share options schemes operated by the company, 1,965,555 were at exercise prices above the market price on 25 September 2001, and 94,926 were at exercise prices below the market price on that date.

No options lapsed during the period 1 August 2000 to 31 July 2001.

No options have been granted or exercised or have lapsed during the period 1 August to 25 September 2001.

Deferred Share Scheme options were granted on 4 December 2000 at an Exercise Price of 0.1p per share and match shares purchased in the market by the grantee on that day. At 31 July 2001 the Deferred Share Scheme held 266,811 shares for the benefit of senior executives (including the directors as disclosed above). The market value of these shares at that date was £2.06m and dividends of approximately £56,770 were waived in the year in respect of the shares.

With the exception of Mr G M Kennedy (who retired on 4 August 2000), no other director held any options over the company's shares during the period 1 August 2000 to 31 July 2001.

>STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and the group at the end of the year, and of the profit or loss of the group for that period. In preparing those accounts, the directors are required to:

– select suitable accounting policies and then apply them consistently;

– make judgements and estimates that are reasonable and prudent;

– state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts;

– prepare the accounts on the going concern basis unless it is inappropriate to assume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safe-guarding the assets of the company and hence for taking reasonable steps for the prevention of fraud and other irregularities.

> INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SMITHS GROUP plc

We have audited the financial statements which comprise the financial statements such as the profit and loss account, the balance sheet, the cash-flow statement, the statement of total recognised gains and losses and the related notes, which have been prepared under the historical cost convention and the accounting policies set out in the statement of accounting policies. We have also examined the amounts disclosed relating to the emoluments, share options and long-term incentives of the directors which form part of the Remuneration report.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, United Kingdom Auditing Standards issued by the Auditing Practices Board and the Listing Rules of the Financial Services Authority.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the directors' report, the chairman's statement, the chief executive review, the business review, the financial review and the corporate governance statement.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the company's or group's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and the group at 31 July 2001 and of the results and cash-flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
London
5 October 2001

>CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Note	Year ended 31 July 2001 Ordinary activities £m	Discontinued businesses £m	Goodwill amortisation £m	Exceptional items £m	Total £m
Continuing operations		3,398.3				3,398.3
Acquisitions		67.9				67.9
Discontinued businesses			1,492.0			1,492.0
Turnover	1 & 2	3,466.2	1,492.0			4,958.2
Continuing operations	3 & 4	516.0		(31.0)	(115.8)	369.2
Acquisitions		8.6		(3.6)		5.0
Discontinued businesses			123.7	(14.1)	(17.7)	91.9
Operating profit	5 & 6	524.6	123.7	(48.7)	(133.5)	466.1
Share of profits of associated companies			3.0			3.0
Total group operating profit		524.6	126.7	(48.7)	(133.5)	469.1
Exceptional items – merger costs	6				(54.2)	(54.2)
– loss on disposal of businesses	6				(286.0)	(286.0)
– write-down of goodwill on anticipated future disposals	6				(125.0)	(125.0)
Profit before interest and tax		524.6	126.7	(48.7)	(598.7)	3.9
Net interest payable	7	(76.5)	(39.7)			(116.2)
Profit/(loss) before taxation		448.1	87.0	(48.7)	(598.7)	(112.3)
Taxation	9	(129.9)	(26.3)	3.6	60.5	(92.1)
Profit/(loss) after taxation		318.2	60.7	(45.1)	(538.2)	(204.4)
Minority interests		(1.1)	(0.5)			(1.6)
Profit/(loss) for the period		317.1	60.2	(45.1)	(538.2)	(206.0)
Dividends	10	(199.5)				(199.5)
Retained profit/(loss)	29 & 30	117.6	60.2	(45.1)	(538.2)	(405.5)
Earnings/(loss) per share	11					
Basic		57.4p	10.9p	(8.2p)	(97.4p)	(37.3p)
Fully-diluted		57.2p	10.8p	(8.1p)	(97.0p)	(37.1p)

Note: Dividends totalling £199.5m include a special interim dividend of 12p per share (£60.6m) paid on TI Group plc shares in issue prior to the merger.

>STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	2001 £m	2000 £m
(Loss)/profit for the financial year attributable to shareholders	(206.0)	324.0
Exchange adjustments	(10.3)	23.2
Taxation recognised on exchange gains:		
Current – UK		(2.7)
Deferred – US	(2.4)	(6.6)
	(218.7)	337.9

There is no material difference between the profit on ordinary activities or retained (loss)/profit for the year stated above, and their historical cost equivalents.

Notes on pages 52 to 72 form part of these accounts.

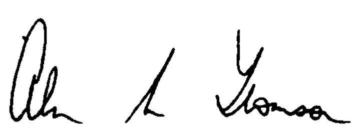
	Note	Ordinary activities £m	Discontinued businesses £m	Goodwill amortisation £m	Exceptional items £m	Total £m
						Year ended 31 July 2000
Continuing operations		3,061.5				3,061.5
Acquisitions						
Discontinued businesses			1,591.4			1,591.4
Turnover	1 & 2	3,061.5	1,591.4			4,652.9
Continuing operations	3 & 4	464.9		(20.5)	(10.6)	433.8
Acquisitions						
Discontinued businesses			153.6	(15.0)	(8.7)	129.9
Operating profit	5 & 6	464.9	153.6	(35.5)	(19.3)	563.7
Share of profits of associated companies			4.3			4.3
Total group operating profit		464.9	157.9	(35.5)	(19.3)	568.0
Exceptional items – merger costs						
– loss on disposal of businesses	6				(3.3)	(3.3)
– write-down of goodwill on anticipated future disposals						
Profit before interest and tax		464.9	157.9	(35.5)	(22.6)	564.7
Net interest payable	7	(37.1)	(43.6)			(80.7)
Profit before taxation		427.8	114.3	(35.5)	(22.6)	484.0
Taxation	9	(131.0)	(35.0)	1.6	6.1	(158.3)
Profit after taxation		296.8	79.3	(33.9)	(16.5)	325.7
Minority interests		(1.0)	(0.7)			(1.7)
Profit for the period		295.8	78.6	(33.9)	(16.5)	324.0
Dividends	10	(165.6)				(165.6)
Retained profit	30	130.2	78.6	(33.9)	(16.5)	158.4
Earnings per share	11					
Basic		54.2p	14.4p	(6.2p)	(3.0p)	59.4p
Fully-diluted		54.0p	14.4p	(6.2p)	(3.0p)	59.2p

>BALANCE SHEETS

	Note	Consolidated 31 July 2001 £m	Consolidated 31 July 2000 £m	Company 31 July 2001 £m	Company 31 July 2000 £m
Fixed assets					
Intangible assets	14	**678.3**	851.4		
Tangible assets	15	**620.1**	977.2	**47.0**	47.9
Investments and advances – TI Automotive Limited preference shares	17	**325.0**		**325.0**	
– other	17	**12.1**	41.6	**649.7**	778.0
		1,635.5	1,870.2	**1,021.7**	825.9
Current assets					
Assets held for resale			7.0		
Stocks	18	**567.6**	616.8	**43.9**	38.4
Debtors – amounts falling due within one year	19	**752.4**	997.5	**77.4**	58.5
– amounts falling due after more than one year	19	**166.2**	182.6	**46.1**	37.6
Cash at bank and on deposit	22	**117.2**	322.1	**65.7**	19.3
		1,603.4	2,126.0	**233.1**	153.8
Creditors: amounts falling due within one year	21	**(1,181.4)**	(1,379.0)	**(484.5)**	(180.7)
Net current assets/(liabilities)		**422.0**	747.0	**(251.4)**	(26.9)
Total assets less current liabilities		**2,057.5**	2,617.2	**770.3**	799.0
Creditors: amounts falling due after more than one year	21	**(970.2)**	(1,609.9)	**(174.4)**	(168.2)
Provisions for liabilities and charges	25	**(208.9)**	(205.2)	**(11.5)**	(19.5)
Net assets		**878.4**	802.1	**584.4**	611.3
Capital and reserves					
Called up share capital	28	**138.9**	136.9	**138.9**	79.3
Share premium account	29	**146.1**	119.7	**146.1**	119.7
Revaluation reserve	29	**3.2**	3.3	**0.5**	0.6
Merger reserve	29	**234.8**	234.8	**180.5**	180.5
Profit and loss account	29	**342.7**	292.7	**118.4**	231.2
Shareholders' equity	30	**865.7**	787.4	**584.4**	611.3
Minority equity interests		**12.7**	14.7		
Capital employed		**878.4**	802.1	**584.4**	611.3

The accounts on pages 48 to 73 were approved by the Board of Directors on 5 October 2001 and were signed on its behalf by:

Keith Orrell-Jones
Chairman



Alan M Thomson
Finance Director

>CASH-FLOW STATEMENT

	Note	Year ended 31 July 2001 £m	Year ended 31 July 2000 £m
Reconciliation of operating profit to net cash inflow from operating activities			
Operating profit		**466.1**	563.7
Exceptional items		**133.5**	19.3
Operating profit before exceptional items		**599.6**	583.0
Goodwill amortisation		**48.7**	35.5
Depreciation		**139.3**	132.0
Increase in stocks		**(34.4)**	(12.2)
(Increase)/decrease in debtors		**(71.7)**	36.5
Increase/(decrease) in creditors		**19.5**	(85.6)
Net cash inflow from normal operating activities		**701.0**	689.2
Restructuring costs		**(74.2)**	(22.6)
Net cash inflow from operating activities		**626.8**	666.6

Cash-flow statement

	Note	Year ended 31 July 2001 £m	Year ended 31 July 2000 £m
Net cash inflow from operating activities before merger costs		**626.8**	666.6
Merger costs		**(54.2)**	
Net cash inflow from operating activities after merger costs		**572.6**	666.6
Dividends received from joint ventures and associates			0.1
Returns on investments and servicing of finance	23	**(117.9)**	(69.6)
Tax paid		**(115.6)**	(114.9)
Capital expenditure	15	**(188.0)**	(168.2)
		151.1	314.0
Acquisitions and disposals	26 & 27	**368.6**	(590.5)
Equity dividends paid		**(171.3)**	(145.3)
Management of liquid resources	22	**193.6**	87.4
Financing	22	**(448.2)**	326.7
Increase/(decrease) in cash		**93.8**	(7.7)

	Note	Year ended 31 July 2001 £m	Year ended 31 July 2000 £m
Reconciliation to net debt			
Net debt at 1 August		**(1,465.7)**	(973.4)
Increase/(decrease) in cash		**93.8**	(7.7)
Reduction in short-term deposits	22	**(193.6)**	(87.4)
(Increase)/decrease in other borrowings	22	**452.8**	(329.4)
Loan note issues net of repayments	22	**3.5**	
Term debt of acquisitions assumed			(37.9)
Term deposits acquired with acquisitions	26	**19.0**	8.4
Debt de-consolidated on disposals	27	**19.1**	
Exchange variation		**(48.7)**	(38.3)
Net debt at 31 July	22	**(1,119.8)**	(1,465.7)

Notes on pages 52 to 72 form part of these accounts.

1 Analyses of turnover, profit and assets (ordinary activities)	Turnover 2001 £m	Turnover 2000 £m	Profit 2001 £m	Profit 2000 £m	Assets 2001 £m	Assets 2000 £m
Market						
Aerospace	**1,328.6**	1,144.5	**210.1**	177.7	**766.0**	510.6
Sealing Solutions	**1,164.7**	1,064.0	**127.5**	121.1	**493.5**	427.8
Medical	**452.5**	403.4	**93.3**	85.2	**369.5**	345.2
Industrial	**520.4**	449.6	**93.7**	80.9	**356.5**	295.2
	3,466.2	3,061.5	**524.6**	464.9	**1,985.5**	1,578.8
Discontinued businesses	**1,492.0**	1,591.4	**126.7**	157.9		674.3
	4,958.2	4,652.9	**651.3**	622.8	**1,985.5**	2,253.1
Goodwill amortisation			**(48.7)**	(35.5)		
Exceptional items			**(598.7)**	(22.6)		
Net interest/net borrowings			**(116.2)**	(80.7)	**(1,119.8)**	(1,465.7)
(Loss)/profit before tax/net assets			**(112.3)**	484.0	**865.7**	787.4
Geographical origin						
United Kingdom	**1,136.7**	1,043.9	**130.5**	140.0	**759.0**	618.8
USA	**1,674.8**	1,336.6	**275.8**	222.9	**990.7**	763.4
US dollars	***$2,428.5m***	*$2,111.8m*	***$399.9m***	*$352.2m*	***$1,416.7m***	*$1,145.1m*
Europe	**635.2**	649.9	**77.4**	73.4	**151.2**	104.7
Other overseas	**295.1**	295.5	**40.9**	28.6	**84.6**	91.9
Inter-company	**(275.6)**	(264.4)				
	3,466.2	3,061.5	**524.6**	464.9	**1,985.5**	1,578.8

Operating profit from continuing activities after exceptional items amounted to £374.2m (2000 £433.8m) after charging goodwill amortisation of £34.6m (2000 £20.5m) and exceptional items of £115.8m (2000 £10.6m).

The contribution from discontinued businesses (predominantly Automotive) comprised turnover of £1,492.0m (2000 £1,591.4m) and operating profits of £109.6m (2000 £138.6m) after charging goodwill amortisation of £14.1m (2000 £15.0m). The net operating assets attributable to discontinued businesses in 2000 was £674.3m.

The above segmental analyses include the following contributions from acquisitions made during the year:

	Turnover	Profit
Market		
Aerospace	**47.6**	**7.5**
Sealing Solutions	**16.3**	**1.8**
Industrial	**4.0**	**(0.7)**
	67.9	**8.6**
Geographical origin		
USA	**51.6**	**6.8**
Europe	**16.3**	**1.8**
	67.9	**8.6**

Goodwill amortisation of £48.7m comprised:

	Continuing activities £m	Acquisitions £m	Discontinued businesses £m	2001 Total £m
Aerospace	11.2	2.6		**13.8**
Sealing Solutions	11.7	0.5		**12.2**
Medical	2.2			**2.2**
Industrial	5.9	0.5		**6.4**
Automotive			14.1	**14.1**
	31.0	3.6	14.1	**48.7**

2 Analysis of turnover by destination (ordinary activities)

	2001 £m	2000 £m
United Kingdom	**563.6**	600.3
USA	**1,595.6**	1,295.8
Europe	**710.5**	654.0
Japan	**124.4**	111.9
Other overseas	**472.1**	399.5
	3,466.2	3,061.5
Discontinued businesses	**1,492.0**	1,591.4
	4,958.2	4,652.9

3 Cost of sales

Cost of sales amounted to £2,040.2m (2000 £1,862.3m) relating to ordinary activities, including £46.7m in respect of acquisitions made during the year. Total cost of sales including discontinued was £3,196.0m (2000 £3,082.4m).

4 Operating expenses

		2001 £m	2000 £m
Continuing operations			
Distribution costs		**357.7**	257.5
Administrative expenses	– before goodwill amortisation	**531.1**	476.9
	– goodwill amortisation	**31.0**	20.5
		919.8	754.9
Acquisitions			
Distribution costs		**3.5**	
Administrative expenses	– before goodwill amortisation	**9.1**	
	– goodwill amortisation	**3.6**	
		16.2	
Total operating expenses	– continuing operations	**936.0**	754.9
	– discontinued businesses	**226.6**	232.6
		1,162.6	987.5

Operating expenses for discontinued businesses comprised distribution costs of £62.6m (2000 £61.5m) and administrative expenses of £164.0m (2000 £171.1m).

5 Operating profit is after charging

			2001 £m	2000 £m
Goodwill amortisation			**48.7**	35.5
Depreciation of fixed assets			**139.3**	132.0
Research and development expenditure			**109.5**	97.3
Operating leases	– land and buildings		**26.8**	24.5
	– other		**12.9**	10.3
Auditors	– audit fees:	parent company	**0.1**	0.1
		other	**3.3**	5.1
	– other fees:	TI Group plc 31 December 2000 audit	**3.5**	
		other	**1.3**	1.8
Restructuring and redundancy costs and loss on disposal of fixed assets			**133.5**	19.3

Fees totalling £0.4m (2000 £1.4m) paid to the auditors were capitalised to goodwill. Of the £0.4m, £nil (2000 £0.1m) was incurred in respect of the UK.

Further fees of £3.0m were paid to the auditors in respect of professional services relating to the merger with TI Group plc and the subsequent demerger of TI Automotive Limited.

6 Exceptional items

The company incurred significant exceptional charges arising from the merger with TI Group and the subsequent demerger of Automotive. The tables below show separately those involving cash outflow.

Charges involving cash outflow	Charged to operating profit £m	Charged below operating profit £m	2001 £m	2000 £m
Head Office closures	43.9		**43.9**	
Operational restructuring – continuing businesses	71.9		**71.9**	10.6
Merger costs		54.2	**54.2**	
	115.8	54.2	**170.0**	10.6
Operational restructuring – Automotive	17.7		**17.7**	8.7
Charge before tax relief	133.5	54.2	**187.7**	19.3
Tax relief	(38.1)		**(38.1)**	(6.1)
	95.4	54.2	**149.6**	13.2

The charges for head office closures relate to the closure of premises in Abingdon, Central London and New York. All three closures were completed in the year.

The charge for operational restructuring of £71.9m relates to the transfer of work to low cost facilities and other restructuring activities. The charge is analysed £42.5m Sealing Solutions and £29.4m Aerospace.

The cash spend in the year for head office closures and operational restructuring including Automotive was £74.2m.

The merger costs relate to professional fees and stamp duty incurred in the merger with TI Group plc.

The £17.7m Automotive restructuring was completed in January 2001.

Other exceptional charges	Automotive £m	Other disposals £m	Total disposals £m	Anticipated disposals £m	2001 £m	2000 £m
(Surplus)/deficit of consideration over net assets, fees and expenses	(46.3)	(13.0)	(59.3)		**(59.3)**	3.3
Goodwill written off to reserves	345.3		345.3	125.0	**470.3**	
Charge before tax relief	299.0	(13.0)	286.0	125.0	**411.0**	3.3
Tax relief	(22.4)		(22.4)		**(22.4)**	
	276.6	(13.0)	263.6	125.0	**388.6**	3.3

The Automotive demerger and the other disposals are detailed in note 27.

The charge in respect of anticipated disposals relates to goodwill previously written off to reserves. The businesses in question are principally Air Movement businesses and various subsidiaries of EIS Group plc. Of the total charge of £125m the Industrial division accounts for £54m with the remainder principally Sealing Solutions.

Subsequent to the year-end the company disposed of the Plenty Group and two European hose businesses.

7 Net interest payable

	2001 £m	2000 £m
Interest receivable	**13.5**	13.6
Other financing gains		4.9
Interest payable:		
Bank loans and overdrafts repayable within five years	**(35.1)**	(40.7)
Other loans repayable within five years	**(69.0)**	(55.6)
Other loans repayable in more than five years	**(22.9)**	(2.4)
Finance leases	**(2.7)**	(0.5)
	(116.2)	(80.7)

8 Profit attributable to the parent company

Profits for the financial year of £23.2m (2000 £91.0m) were recorded in the accounts of Smiths Group plc. The directors have taken advantage of the exemption afforded by s230 of the Companies Act 1985 not to present a separate profit and loss account for the parent company.

9 Taxation

	2001 £m	2000 £m
Taxation on the profit for the year		
UK corporation tax at 30% (2000 – 30%)	**95.8**	81.1
Double taxation relief	**(20.9)**	(13.3)
	74.9	67.8
Overseas taxation	**84.4**	94.6
Share of associates' taxation	**1.0**	0.9
	160.3	163.3
Tax relief on exceptional items (note 6)	**(60.5)**	(6.1)
Current taxation	**99.8**	157.2
Deferred taxation	**(7.7)**	1.1
	92.1	158.3
Tax reconciliation		
Loss before taxation	**(112.3)**	
Effective taxation at 30%	**(33.7)**	
Effect of higher overseas rates of tax	**7.4**	
Effect of reversal of timing differences	**7.7**	
Tax relief on employee share schemes	**(0.7)**	
Tax effect of exceptional charges	**119.1**	
Current tax charge for the year	**99.8**	

10 Dividends

	2001 £m	2000 £m
Ordinary interim paid 8.75p per share (2000 8.1p)	**48.5**	25.4
Ordinary final proposed 16.25p per share (2000 15.7p)	**90.4**	49.9
Ordinary final paid by TI Group plc in respect of the year ended 31 December 1999		60.1
Ordinary interim paid by TI Group plc in respect of the period ended 30 June 2000		30.2
Special dividend paid by TI Group plc in respect of the year ended 31 December 2000	**60.6**	
	199.5	165.6

As stated in note 28, scrip dividends amounting to £18.1m were taken up from the 1999-2000 final dividend.

11 Earnings per share

	2001	2000
Separate figures are given for earnings per share related to the weighted average number of shares in issue:		
Basic	**552,770,686**	545,391,448
Effect of dilutive share options	**2,113,803**	1,568,652
Fully-diluted	**554,884,489**	546,960,100

12 Post-retirement benefits

Smiths Group operates a number of pension schemes throughout the world. The principal schemes are located in the UK (the Smiths Industries Pension Scheme and the TI Group Pension Scheme) and in the US and are of the defined benefit type, with assets held in separate trustee-administered funds.

For the principal schemes the regular pension cost is assessed using the Projected Unit method. For the purposes of the accounting disclosure requirements of FRS17 (see page 56) the most recent full actuarial valuations of the principal schemes have been updated to 31 July 2001 by qualified independent actuaries. The most recent full actuarial valuations of the principal UK schemes were performed as at:

Smiths Industries Pension Scheme	31 March 1998
TI Group Pension Scheme	5 April 1999

The most recent valuations of the US plans were performed variously at 1 August 2000 and 31 December 2000.

At these dates the market values of the principal schemes' assets were £2,049m for the UK schemes and $491m (excluding the Automotive division) for the US plans and the aggregate funding levels were 119% and 118% respectively. The funding levels were determined by comparing the market value of the funds' assets with the value of benefits accrued at the respective valuation dates.

12 Post-retirement benefits continued

In the UK, the Smiths Industries Pension Scheme valuation made allowance for future annual salary increases at approximately 5% and for pension increases of approximately 3%. The future investment return assumed in assessing the present value of future benefits was 6% for pensioner liabilities and 7% for active member liabilities. The TI Group Pension Scheme valuation made allowance for average annual salary increases (inclusive of promotion and merit increases) at 6.5–7% and for pension increases of 3.75–4.0%. Broadly matching assets are held for the majority of benefits of former members and pensioners. The future investment return assumed in assessing the present value of future benefits for active member liabilities was 8.5% and annual dividend increases of 5.5% was assumed. In the US plans discount rates of 7.75–8% were used and allowances were made for salary increases of 4.5–5.5%.

The regular pension cost is assessed at each actuarial valuation. The variation from regular pension cost, which recognises the excess of assets over liabilities of the pension schemes, is spread over the average remaining working life of relevant employees, generally between 10 and 15 years.

Contributions to these schemes are made on the advice of independent qualified actuaries, using variously the Projected Unit method and the Entry Age Normal method with the objective that the benefits be fully funded during the scheme members' working lives.

A prepayment of £145.4m (2000 £135.4m) is included in debtors.

The pension costs of other schemes operated by the group were assessed in accordance with local practice. The group provides a defined contributions (401K) plan for its US employees and post-retirement healthcare benefit plans, principally in the US. The cost of the post-retirement healthcare benefits is assessed by independent qualified actuaries and provided for in accordance with SSAP24 (see note 25). The major assumptions used in the latest plan valuations, which were performed variously as at 1 January 1999 and 29 July 2000 are discount rates of 7–7.75% and a long-term rate of increase in healthcare costs of 5%.

FRS17 Retirement Benefits

Financial Reporting Standard 17 Retirement Benefits ('FRS17') will change fundamentally the calculation and reporting of the cost of retirement benefits. The disclosures below relate to all retirement benefit plans in the UK and the US. Plans in other territories are not material.

The principal assumptions used by the independent qualified actuaries in updating the most recent valuations of all the UK and US schemes to 31 July 2001 for FRS17 purposes were:

	UK	US
Rate of increase in salaries	4.00%	4.50%
Rate of increase in pensions	2.50%	n/a
Discount rate	6.00%	7.25%
Inflation rate	2.50%	3.50%
Long-term healthcare cost increases	4.50%	5.00%

The assets in the schemes and the expected rates of return as at 31 July 2001 were:

	UK schemes		US schemes	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m
Equities	8.0%	1,012	9.0%	160
Government bonds	5.2%	738	5.5%	150
Corporate bonds	6.0%	371	7.25%	23
Property	7.0%	118	n/a	n/a
Other	5.0%	81	3.5%	6
Total market value		2,320		339
Present value of scheme liabilities		1,990		350
Surplus/(deficit)		330		(11)
Unfunded pension plans		(17)		(5)
Post-retirement healthcare		(15)		(70)
		298		(86)
Related deferred tax asset/(liability)		(89)		33
Net pension asset/(liability)		209		(53)

12 Post-retirement benefits continued

If FRS17 had been adopted in the financial statements, the group's net assets and profit and loss reserve at 31 July 2001 would be as follows:

	£m
Net assets excluding pension asset	863
Pension asset	156
	1,019
Profit and loss reserve excluding pension asset	328
Pension reserve	156
Profit and loss reserve	484

13 Employees

	2001 £m	2000 £m
Staff costs during the year		
Wages and salaries	**1,213.4**	1,125.0
Social Security	**183.6**	169.8
Company pension costs	**16.9**	20.7
	1,413.9	1,315.5

The average number of persons employed was:	2001	2000
Aerospace	**12,234**	11,681
Sealing Solutions	**14,618**	14,883
Medical	**4,607**	4,568
Industrial	**5,328**	5,213
Automotive	**19,229**	21,218
	56,016	57,563

Details of directors' remuneration are given on pages 43 to 46.

14 Intangible fixed assets

	£m
Goodwill	
Cost	
At 1 August 2000	893.1
Acquired during the year	133.4
Arising on prior year acquisitions	4.8
Disposal of TI Automotive Limited	(312.3)
Exchange adjustments	19.6
At 31 July 2001	**738.6**
Amortisation	
At 1 August 2000	41.7
Charge for the year	48.7
Disposal of TI Automotive Limited	(31.0)
Exchange adjustments	0.9
At 31 July 2001	**60.3**
Net book value at 31 July 2001	**678.3**
Net book value at 1 August 2000	851.4

15 Tangible fixed assets

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Consolidated				
Cost or valuation				
At 1 August 2000	459.6	1,173.4	456.1	2,089.1
Exchange adjustments	5.8	19.8	5.6	31.2
Additions	12.8	156.3	51.8	220.9
Acquisitions	0.1	11.2	30.6	41.9
Disposals	(17.6)	(62.9)	(37.8)	(118.3)
Automotive demerger	(129.5)	(558.8)	(61.3)	(749.6)
At 31 July 2001	331.2	739.0	445.0	1,515.2
Depreciation				
At 1 August 2000	127.6	670.2	314.1	1,111.9
Exchange adjustments	2.0	12.2	4.9	19.1
Charge for the year	11.1	82.1	46.1	139.3
Acquisitions		2.4	23.4	25.8
Disposals	(10.9)	(39.0)	(30.0)	(79.9)
Automotive demerger	(30.3)	(252.5)	(38.3)	(321.1)
At 31 July 2001	99.5	475.4	320.2	895.1
Net book value				
At 31 July 2001	**231.7**	**263.6**	**124.8**	**620.1**
At 1 August 2000	332.0	503.2	142.0	977.2
Company				
Cost or valuation				
At 1 August 2000	30.4	15.4	71.3	117.1
Additions	0.4	1.0	6.7	8.1
Transfers		0.1	(0.8)	(0.7)
Disposals	(0.5)		(3.2)	(3.7)
At 31 July 2001	30.3	16.5	74.0	120.8
Depreciation				
At 1 August 2000	3.0	11.6	54.6	69.2
Transfers			(0.1)	(0.1)
Charge for the year	0.6	0.8	6.3	7.7
Disposals	(0.1)		(2.9)	(3.0)
At 31 July 2001	3.5	12.4	57.9	73.8
Net book value				
At 31 July 2001	**26.8**	**4.1**	**16.1**	**47.0**
At 1 August 2000	27.4	3.8	16.7	47.9

The net book value of assets under finance leases included in Plant and Machinery is £2.0m (2000 £7.9m).

	Consolidated		Company	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Land and buildings				
Cost	**324.1**	452.3	**29.8**	29.8
Valuation 1974	**7.1**	7.3	**0.5**	0.6
	331.2	459.6	**30.3**	30.4
Freehold	**305.4**	423.0	**30.1**	30.2
Long leasehold	**9.3**	14.4	**0.2**	0.2
Short leasehold	**16.5**	22.2		
	331.2	459.6	**30.3**	30.4

15 Tangible fixed assets continued

If land and buildings had not been revalued they would have been included at the following amounts:

	Consolidated 2001 £m	Consolidated 2000 £m	Company 2001 £m	Company 2000 £m
Cost	**327.4**	485.6	**29.8**	29.8
Aggregate depreciation	**98.7**	126.8	**3.5**	3.0

The company's properties were revalued on the basis of open market valuation in 1974, and that valuation was incorporated into the financial statements. These values have been retained under the transitional provisions of FRS15, but the directors do not intend to adopt a policy of annual revaluations in the future. A quincentennial external revaluation of the company's properties was carried out as at 31 July 1999 which disclosed a surplus of £20m over 31 July 2001 book values.

Capital expenditure – cashflow		
Purchase of tangible fixed assets	**226.4**	191.2
Less: proceeds of disposals	**(38.4)**	(23.0)
	188.0	168.2

16 Capital commitments

	2001 £m	2000 £m
Estimated commitments not included in the accounts		
Company	**1.5**	1.1
Subsidiaries	**15.3**	12.7
	16.8	13.8

17 Investments and advances

	Consolidated 2001 £m	Consolidated 2000 £m	Company 2001 £m	Company 2000 £m
At cost less amounts written off				
Subsidiary companies			**649.7**	778.0
Unlisted investments				
TI Automotive Limited preference shares	**325.0**		**325.0**	
Other trade investments and advances	**3.7**	18.9		
Own shares	**8.4**	22.7		
	337.1	41.6	**974.7**	778.0
Investments in subsidiaries				
Shares at cost			**823.5**	521.2
Due from subsidiaries			**337.0**	401.4
			1,160.5	922.6
Due to subsidiaries			**(510.8)**	(144.6)
			649.7	778.0

TI Automotive Limited preference shares arise from the demerger of the former Automotive Systems division from the Smiths Group and are held at cost. They carry a fixed cumulative preference dividend at the rate of 15% per annum. 1/3 of the dividend is payable each year, subject to certain financial conditions having been met, on 25 July, with the first payment due on 25 July 2002. The preference shares are redeemable, together with unpaid dividends, following full repayment of outstanding liabilities of TI Automotive Limited under its bank facilities.

The company also holds 19.99% of the issued ordinary share capital of TI Automotive Limited. The shares confer 19.99% of the voting rights attaching to ordinary shares and additionally confer the right to appoint the Chairman and to benefit from compulsory transfer provisions which oblige the other shareholders to sell their shares to a purchaser making an offer accepted by Smiths Group subject to certain conditions. The ordinary shares are recorded at nil value in these accounts.

17 Investments and advances continued

The company's principal subsidiaries and their countries of incorporation are:

England
Smiths Aerospace Limited*
Aerostructures Hamble Limited
Graseby Dynamics Limited
Graseby Medical Limited
Portex Limited*
Smiths Industries Industrial Group Limited*

Europe
SIMS Deutschland GmbH
FRB Connectron SA (France)
Interconnectron GmbH (Germany)
Lips BV

Japan
Japan Medico Co. Limited (62%)

USA
Smiths Group North America, Inc.*
Smiths Aerospace, Inc.
Actuation Systems, Inc.
Barringer Instruments, Inc.
Tri Industries, Inc.
John Crane, Inc.
SIMS Portex, Inc.
Deltec, Inc.
BCI, Inc.
Level 1, Inc.
Flexible Technologies, Inc.
Tutco, Inc.
Hypertronics Corporation
PolyPhaser Corporation
Sabritec, Inc.
Transtector Systems, Inc.

All subsidiaries marked * are 100% owned by the company direct. The others are 100% owned through intermediate holding companies, with the exception of Japan Medico, which is 62% owned by the company. Shareholdings are of ordinary shares, ordinary stock units or common stock. All subsidiaries operate in their country of incorporation.

18 Stocks

	Consolidated		Company	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Stocks comprise				
Raw materials and consumables	**154.3**	222.3	**2.4**	2.4
Work in progress	**199.7**	179.5	**35.8**	31.9
Finished goods	**235.0**	235.6	**12.8**	11.8
	589.0	637.4	**51.0**	46.1
Less: payments on account	**(21.4)**	(20.6)	**(7.1)**	(7.7)
	567.6	616.8	**43.9**	38.4

19 Debtors

	Consolidated		Company	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Amounts falling due within one year				
Trade debtors	**641.6**	912.4	**48.5**	44.3
Amounts recoverable on contracts	**61.3**	32.9	**7.2**	6.2
Amounts owed by subsidiaries			**12.0**	3.7
Other debtors	**18.6**	19.8	**5.4**	1.1
Prepayments and accrued income	**30.9**	32.4	**4.3**	3.2
	752.4	997.5	**77.4**	58.5
Amounts falling due after more than one year				
Other debtors	**20.8**	39.2		
Deferred taxation (note 20)		8.0	**1.2**	
Pensions prepayment (note 12)	**145.4**	135.4	**44.9**	37.6
	918.6	1,180.1	**123.5**	96.1

20 Deferred taxation

	Full provision basis Consolidated 2001 £m	2000 £m	Company 2001 £m	2000 £m
Deferred taxation				
Accelerated tax depreciation	**(18.8)**	(41.5)	**(10.6)**	(6.2)
Post-retirement benefits	**28.3**	46.5		
Pension prepayment	**(39.5)**	(17.2)	**(13.5)**	(11.3)
Short-term and other timing differences	**28.3**	20.2	**25.3**	9.9
Net deferred tax (liability)/asset	**(1.7)**	8.0	**1.2**	(7.6)
Movements during the year				
At 1 August	**8.0**	12.4	**(7.6)**	(4.3)
Exchange adjustments	**3.2**	2.6		
Disposals	**(18.2)**	0.4		
Charge for the year	**7.7**	(1.1)	**1.5**	(0.6)
Recognised on exchange gains and losses	**(2.4)**	(6.6)		
Other		0.3	**7.3**	(2.7)
At 31 July	**(1.7)**	8.0	**1.2**	(7.6)

The company has not adopted FRS19 for 2001, as the application of some aspects of the Standard are still subject to debate. However, in anticipation of its adoption for 2002 the company has made additional disclosure, and has reconsidered the probability that deferred tax liabilities and assets will crystallise. As a result, the company has accounted in full for all timing differences above. The impact of the change from partial provisioning under SSAP15 is not material, and hence only the full provision basis table is presented.

21 Creditors

	Consolidated 2001 £m	2000 £m	Company 2001 £m	2000 £m
Amounts falling due within one year				
Bank loans and overdrafts	**37.8**	107.8	**228.0**	23.6
Finance leases	**1.5**	3.0		
Short-term loans	**303.3**	137.5	**2.0**	4.5
Total short-term indebtedness (note 22)	**342.6**	248.3	**230.0**	28.1
Trade creditors	**285.1**	496.6	**21.6**	18.7
Bills of exchange payable	**3.4**	12.4		
Amounts owed to subsidiaries			**2.1**	1.5
Other creditors	**51.0**	60.9	**6.0**	4.0
Proposed dividend	**90.4**	93.7	**90.4**	49.9
Corporate taxation	**60.4**	87.9	**54.0**	23.7
Other taxation and social security costs	**23.3**	38.8		1.8
Accruals and deferred income	**325.2**	340.4	**80.4**	53.0
	1,181.4	1,379.0	**484.5**	180.7
Amounts falling due after more than one year				
Term loans (note 22)	**892.5**	1,527.5	**161.5**	150.8
Finance leases	**1.9**	12.0		
Total long-term indebtedness	**894.4**	1,539.5	**161.5**	150.8
Other creditors	**75.8**	70.4	**12.9**	17.4
	970.2	1,609.9	**174.4**	168.2

22 Borrowings and net debt

Short-term debtors and creditors have been excluded from all the following disclosures, other than the currency risk disclosures.

As at 31 July 2001	Fixed borrowings – Weighted average Interest rate	Fixed borrowings – Weighted average Years fixed	Fixed borrowings Amount £m	Floating borrowings £m	**Total 2001 £m**
Currencies					
Sterling	7.03%	7	347.5	272.8	**620.3**
US Dollar	8.70%	2	59.4	269.9	**329.3**
EMU participants	5.51%	1	123.9	76.7	**200.6**
Japanese Yen	2.30%	3	21.3	11.3	**32.6**
Other			30.9	23.3	**54.2**
			583.0	654.0	**1,237.0**
Cash and deposits (note 23b)					**(117.2)**
Net debt					**1,119.8**
Maturity					
On demand/under one year			31.9	310.7	**342.6**
One to two years			37.7	52.9	**90.6**
Two to five years			364.7	142.1	**506.8**
Over five years			148.7	148.3	**297.0**
			583.0	654.0	**1,237.0**

As at 31 July 2000	Fixed borrowings – Weighted average Interest rate	Fixed borrowings – Weighted average Years fixed	Fixed borrowings Amount £m	Floating borrowings £m	Total 2000 £m
Currencies					
Sterling	7.27%	15	170.2	493.4	663.6
US Dollar	7.59%	2	186.0	393.1	579.1
EMU participants				405.5	405.5
Japanese Yen				42.5	42.5
Other				97.1	97.1
			356.2	1,431.6	1,787.8
Cash and deposits					(322.1)
Net debt					1,465.7
Maturity					
On demand/under one year			6.5	241.8	248.3
One to two years			0.1	429.9	430.0
Two to five years			202.0	606.1	808.1
Over five years			147.6	153.8	301.4
			356.2	1,431.6	1,787.8

The company's policy is to keep a broadly equal mix between fixed and floating rate debt after taking into account interest rate contracts. Shortly after 31 July 2000, TI Group entered into certain swap arrangements which brought the mix of fixed and floating rate borrowings in line with policy.

22 Borrowings and net debt continued

Borrowing facilities

The floating-rate borrowings are related to LIBOR in the UK, to LIBOR and bank funding rates in the US, and to LIBOR and bank base rates in Japan. Borrowings in continental Europe are based mainly on EURIBOR.

The borrowings of all non-UK operations are in local currencies to provide a structural hedge against foreign currency movements on the overseas assets.

The group has two private placement debts. The first has an outstanding principal of $100m (2000 $100m) 8.34% Senior Notes maturing in August 2002 but with the interest rate swapped to floating on $75m. The other has an outstanding principal of $60m (2000 $80m) 8.853% Senior Notes maturing in October 2003. Both debts are placed by Smiths Group North America Inc. with major US institutional investors and are guaranteed by Smiths Group plc.

The medium-term borrowings include TI Group plc unsecured nominal €300m 6.375% bonds maturing in 2005 which are largely swapped to floating interest rates.

The long-term borrowings (greater than five years) of £297m (2000 £301.4m) relate to TI Group plc unsecured nominal £150m 7.875% bonds maturing in 2010 which are swapped to floating interest rates and to a Smiths Group plc unsecured nominal £150m 7.25% bonds maturing in 2016 which remains fixed rate.

The group had the following unused committed borrowing facilities:	2001 £m	2000 £m
Expiring within one year	**35.0**	187.5
Expiring between one and two years	**–**	–
Expiring after two years	**440.9**	229.5
	475.9	417.0

Shortly after the year-end the group's syndicated bank revolving credit facilities were restructured reducing the committed facilities to £236m. The company also has a number of uncommitted facilities and overdraft lines.

		Borrowings		
Analysis of changes in net debt	Cash and deposits £m	Under one year £m	Over one year £m	Net debt £m
As at 1 August 2000	322.1	(245.3)	(1,542.5)	(1,465.7)
Net cash inflow	6.7	(113.4)	200.5	93.8
Deposits acquired with subsidiaries	19.0			19.0
Debt deconsolidated on disposals		19.1		19.1
Other movements in cash/borrowings	(193.6)	3.5	452.8	262.7
Exchange variation	(37.0)	(6.5)	(5.2)	(48.7)
As at 31 July 2001	**117.2**	**(342.6)**	**(894.4)**	**(1,119.8)**

Financing	2001 £m	2000 £m
Reduction in term borrowings	**(456.3)**	(111.7)
Issue of bonds maturing between 2005 and 2016		479.0
Share issues	**8.1**	8.3
Total financing	**(448.2)**	375.6

Management of liquid resources defined as short-term deposits shown in the cash-flow statement comprises a reduction of £193.6m in deposits used to repay longer-term borrowings.

23 Financial instruments

a) Fair values of financial assets and liabilities

We use financial instruments to raise finance for our operations and manage the related financial risks. The group's financial instruments comprise borrowings, cash and liquid resources, interest rate and currency contracts. Short-term debtors and creditors have been excluded from all the following disclosures, other than the currency risk disclosures. The group's policy forbids trading in financial instruments.

Set out below is a year-end comparison of the book value and current fair value of the group's financial instruments by category. Fair values of interest rate swaps, currency swap and forward currency contracts are based on the market price of comparable instruments at the balance sheet date. Where market prices are not available, the fair value has been calculated by discounting cash-flows at prevailing interest and exchange rates.

	2001 Book value £m	2001 Fair value £m	2000 Book value £m	2000 Fair value £m
Cash	117.2	117.2	322.1	322.1
Borrowings – hedge against Yen income			(3.1)	(3.6)
– other short-term	(342.6)	(342.6)	(242.2)	(242.2)
– long-term element	(894.4)	(938.3)	(1,542.5)	(1,550.3)
Net debt – book value/fair value	(1,119.8)	(1,163.7)	(1,465.7)	(1,474.0)
Derivative financial instruments – interest rate swaps		9.8		(0.8)
– currency swaps		0.1		(0.4)
– forward currency contracts		(17.5)		(17.6)
Preference shares (note 17)	325.0	325.0		
Net financial liabilities – book value/fair value	(794.8)	(846.3)	(1,465.7)	(1,492.8)

As described in the Financial Review on pages 29 and 30, the company's policy is to hedge all material contractually committed future sales using forward exchange contracts and currency options. The transactions to which the forward currency contracts relate are mainly expected to occur in 2002 and 2003.

b) Hedges

	Unrecognised gains £m	Unrecognised (losses) £m	Deferred total net gains £m	Total 2001 £m
Net gains/(losses) on hedges at 1 August 2000	14.8	(33.6)	4.7	(14.1)
Net gains/(losses) arising in previous years included in 2001 income	(5.6)	11.0	(0.3)	5.1
Net gains/(losses) not included in 2001 income arising before 1 August 2000	9.2	(22.6)	4.4	(9.0)
Gains and losses arising in 2001 that were not recognised in that year	12.5	(6.7)		5.8
At 31 July 2001	21.7	(29.3)	4.4	(3.2)
Of which:				
Expected to be included in 2002 income	10.1	(14.6)	0.3	(4.2)
Expected to be included in 2003 income or later	11.6	(14.7)	4.1	1.0

	Unrecognised gains £m	Unrecognised (losses) £m	Deferred total net gains £m	Total 2000 £m
Net gains/(losses) on hedges at 1 August 1999	9.9	(10.8)	(0.9)	(1.8)
Net gains/(losses) arising in previous years included in 2000 income	(6.8)	6.2	0.9	0.3
Net gains/(losses) not included in 2000 income arising before 1 August 1999	3.1	(4.6)	–	(1.5)
Gains and losses arising in 2000 that were not recognised in that year	11.7	(29.0)	4.7	(12.6)
At 31 July 2000	14.8	(33.6)	4.7	(14.1)
Of which:				
Expected to be included in 2001 income	11.4	(22.8)	0.3	(11.1)
Expected to be included in 2002 income or later	3.4	(10.8)	4.4	(3.0)

The unrecognised losses on hedges at 31 July 2001 largely relate to forward currency contracts which have been devalued as a result of the strengthening of the US dollar. However, all the gains and losses on the hedging transactions are expected to be matched by losses and gains on the hedged transactions or positions. There are no material gains or losses on hedging instruments within the consolidated balance sheet.

23 Financial instruments continued

c) Interest management

The net interest cash-flow is analysed below:	2001 £m	2000 £m
Interest received	**11.1**	6.2
Financing gains	**2.5**	12.3
Interest paid	**(131.5)**	(88.1)
Net interest	**(117.9)**	(69.6)

	Preference shares (note 17)		Bank balances and cash		Short-term deposits	
d) Financial assets	**2001 £m**	2000 £m	**2001 £m**	2000 £m	**2001 £m**	2000 £m
Sterling	**325.0**		**11.8**	20.2	**12.9**	19.2
US Dollar			**5.0**	17.3	**2.8**	0.4
Canadian Dollar			**25.9**	0.2		
Euro currencies			**14.9**	16.7	**0.8**	188.1
Yen			**8.7**	12.6	**7.3**	6.5
Other			**23.6**	34.1	**3.5**	6.8
	325.0		**89.9**	101.1	**27.3**	221.0
Weighted average interest rate on interest bearing balances			**3.65%**		**3.14%**	

The bank balances and cash comprise £46.8m in respect of short-term balances earning interest, £37.7m in respect of balances which are non-interest earning and £5.5m held as a compensating credits against our Yen term loans. Short-term deposits are invested for periods with maturity under one year on floating rates.

e) Currency exposures

Transactions

More than three-quarters of the company's sales are to markets outside the UK. In part, these are served by our local subsidiaries. In respect of export sales it is the company's policy to hedge all material transaction against fluctuations in exchange rates. The extent to which the company has monetary assets and liabilities in currencies other than in their local currency has been examined. Taking into account the effect of forward contracts and other derivative instruments, the company had no material financial exposure to foreign exchange gains or losses on monetary assets and monetary liabilities denominated in foreign currencies at 31 July 2001.

Translation

Overseas profits are not hedged for translation exposure but overseas earnings are in part hedged by the interest exposure on foreign borrowings used to hedge the overseas assets. Gains and losses arising on net investments overseas and the financial instruments used to hedge the currency exposures are recognised in the statement of total recognised gains and losses.

24 Operating lease commitments

At 31 July 2001 the company had annual commitments under non-cancellable operating leases as follows:

	Land and buildings £m	Others £m
Expiring in less than one year	**5.1**	**3.9**
Expiring between one and five years	**14.5**	**8.6**
Expiring after five years	**12.7**	**–**
	32.3	**12.5**

25 Provisions for liabilities and charges	At 1.8.00 £m	Exchange adjustments £m	Profit and loss account Provisions £m	Releases £m	Acquisitions £m	Utilisation £m	Disposals £m	At 31.7.01 £m
Consolidated								
Post-retirement healthcare	90.8	3.4	3.5			(3.5)		**94.2**
Service guarantees and product liability	36.5	1.1	15.2		0.2	(15.2)		**37.8**
Reorganisation	6.0	0.1	62.6			(24.9)		**43.8**
Property	14.6	0.2	10.2			(2.5)		**22.5**
Litigation	14.9	0.1	2.2	(5.2)		(3.1)		**8.9**
	162.8	4.9	93.7	(5.2)	0.2	(49.2)		**207.2**
Discontinued businesses	42.4	1.8	3.9			(10.7)	(37.4)	
	205.2	6.7	97.6	(5.2)	0.2	(59.9)	(37.4)	**207.2**
Deferred taxation (note 20)								**1.7**
Total provision for liability and charges								**208.9**
Company								
Post-retirement healthcare	2.8							**2.8**
Service guarantees and product liability	5.6		4.2			(3.1)		**6.7**
Reorganisation	0.8					(0.6)		**0.2**
Property	2.3					(0.5)		**1.8**
Litigation	0.4					(0.4)		
	11.9		4.2			(4.6)		**11.5**
Deferred taxation (note 20)	7.6							
	19.5							

Post-retirement healthcare
The company has contractual commitments to provide private healthcare after retirement to a significant number of employees, mostly in the US. The annual charge against profits and the amount of the provision carried forward are based on actuarial assessments of the company's discounted future obligations.

Service guarantees and product liability
Service guarantees and warranties over the company's products typically cover periods of between one and three years. Provision is made for the likely cost of after-sales support based on the recent past experience of individual businesses.

Reorganisation
Significant parts of the company's operations, especially in Aerospace and Sealing Solutions, have been undergoing a phased restructuring programme over the past four years. Full provision is made for schemes approved and committed by the end of each financial year. This year's balance relates mainly to Aerospace sites in the US, and Sealing Solutions businesses in the UK and Europe. This restructuring should be completed by July 2002.

Property
As stated in the Accounting Policies on page 73, where a property is vacant, or sub-let under terms such that rental income is insufficient to meet all outgoings, the company provides for the anticipated future shortfall up to termination of the lease. Provision is also made for the cost of reinstatement work on leased properties where there is an obligation under the lease, and the costs can be reasonably estimated. Where evidence of contamination is found on property in the company's occupation, provision is made for estimated remedial costs pending action on the affected site.

Litigation
The company has on occasion been required to take legal action to protect its patents and other business intellectual property rights against infringement, and to similarly defend itself against proceedings brought by other parties. Provision is made for the anticipated fees and associated costs, based on professional advice as to the likely duration of each case. Provision totalling £5.2m were released relating to litigation settled at less than the anticipated cost.

26 Acquisitions

During the year under review the company acquired the businesses set out below. The fair values are provisional, and will be finalised in the 2002 accounts.

	Dates of acquisition £m	Consideration (including assumed borrowings, net of cash deposits) £m	Goodwill £m	Net assets £m
Fairchild Defense	30.10.00	75.3	58.2	17.1
Barringer	11.05.01	38.6	32.0	6.6
Radio Waves	18.12.00	17.0	15.9	1.1
Other	various	34.9	27.3	7.6
		165.8	133.4	32.4

	Book value £m	Revaluation £m	Consistency of accounting policy £m	Fair value £m
Fixed assets	16.1			16.1
Stock	24.7	(2.9)	(3.3)	18.5
Debtors	23.3	(0.3)		23.0
Creditors	(18.1)	(4.3)	(2.1)	(24.5)
Provisions	(0.1)		(0.1)	(0.2)
Taxation	0.3		(0.8)	(0.5)
Net assets acquired	46.2	(7.5)	(6.3)	32.4
Goodwill				133.4
Consideration – satisfied by cash				165.8
Deferred consideration – prior year acquisitions				32.3
Total acquisition spend				198.1

The acquired businesses at date of acquisition had cash deposits of £19.0m.

Ongoing reviews of the businesses acquired during the year have identified the following principal revaluation and accounting policy adjustments:

Stock and work in progress – reduction of book value to net realisable value where lower than cost, or subject to write-down where stock levels exceed anticipated future requirements.

Creditors – the creation of contract loss reserves in accordance with the company's accounting policy.

In addition an adjustment totalling £4.8m was made to goodwill relating to prior year acquisitions, principally within the Aerospace division.

In accordance with the provisions of FRS10 – Goodwill and Intangible Assets, the company amortises goodwill arising on acquisitions after 1 August 1998 on a straight-line basis over a period of up to 20 years. The charge for the year was £48.7m. Goodwill relating to acquisitions prior to 1 August 1998 has been charged to reserves.

27 Disposals

The principal disposal during the year was TI Automotive Limited which was demerged on 3 July 2001. The table below shows the details of the transaction. The company retained 19.9% of the equity, which is recorded on the balance sheet at nil value. The preference shares are recorded on the balance sheet as an investment at cost.

TI Automotive demerger	£m
Proceeds received	
Gross cash received	615.0
Preference shares	325.0
	940.0
Net assets at 30 June 2001	
Tangible fixed assets	428.5
Associates	16.1
Stock	103.6
Debtors	367.3
Creditors	(346.6)
Provisions	(37.4)
Net cash	23.8
Tangible net assets	555.3
Capitalised goodwill	281.3
	836.6
Fees and expenses	
TI Automotive fees and expenses	10.3
Smiths Group fees and expenses	46.8
	57.1
Surplus of proceeds over net assets, fees and expenses	46.3
Goodwill previously written off to reserves	(345.3)
Loss on sale before tax	(299.0)

The proceeds are subject to adjustment according to the value of net assets at completion. The net asset value is not yet agreed and provision has been made in relation to unresolved issues.

TI Automotive and other disposals	TI Automotive £m	Other £m	Total £m
Profit/(loss) on disposal			
Surplus of proceeds over net assets, fees and expenses	46.3	13.0	59.3
Goodwill previously written off to reserves	(345.3)		(345.3)
Profit/(loss) on sale	(299.0)	13.0	(286.0)
Tax relief	22.4		22.4
	(276.6)	13.0	(263.6)

The other disposals were principally Eschmann Equipment Ltd, Lambda Advanced Analogue Inc and Smiths Hydraulics Company. The combined net assets of the other disposals were £24.0m and the aggregate cash consideration was £37.0m.

Net cash realised from disposals totalled £604.8m. The Automotive demerger included the deconsolidation of term debt of £19.1m.

The disposals contributed £152m cash-flow from operating activities after restructuring costs of £18m. The capital expenditure incurred amounted to £77m.

28 Called up share capital

	Shares	Issued capital £m	Consideration £m
At 1 August 2000	317,215,301	79.3	
Shares issued following merger with TI Group plc	233,604,697	58.4	
Exercise of share options	2,200,195	0.5	8.1
Issues of scrip dividend shares	2,624,134	0.7	18.1*
At 31 July 2001	**555,644,327**	**138.9**	**26.2**

*equivalent cash dividends

28 Called up share capital continued

The authorised capital at 31 July 2001 consisted of 800,000,000 shares of 25p each.

At 31 July 2001 the following options had been granted and were still outstanding:

	Date issued	Number of shares	Subscription prices	Dates normally exercisable
SAYE	1994	182,245	392.0p	1999-2001
	1995	234,513	384.0p	2000-2002
	1996	311,289	572.0p	2001-2003
	1997	575,910	632.0p	2000-2004
	1998	691,810	669.0p	2001-2005
	1999	551,076	721.0p	2002-2006
	2000	1,216,790	612.0p	2003-2007
	2001	2,136,051	608.0p	2004-2008
Executive	1991	8,000	250.0p	1994-2001
	1993	27,521	347.0p	1996-2003
	1993	23,041	395.0p	1996-2003
	1994	113,837	451.0p	1997-2004
	1995	62,500	480.0p	1998-2005
	1995	198,845	632.0p	1998-2005
	1996	472,713	823.0p	1999-2006
	1997	571,355	934.0p	2000-2007
	1998	1,033,611	765.0p	2001-2008
	1999	1,037,927	858.5p	2002-2009
	2000	1,290,100	750.0p	2003-2010
	2000	55,424	765.0p	2003-2010
	2000	190,934	809.0p	2003-2010
	2001	1,779,867	790.0p	2004-2011
SAYE (ex – TI Group plc)	1994	2,356	628.20p	2001
	1995	27,857	689.19p	2002
	1996	110,818	853.86p	2001-2003
	1997	127,805	886.39p	2002-2004
	1998	680,336	719.68p	2001-2005
	1999	353,720	805.07p	2002-2006
	2000	972,781	587.54p	2003-2007
Executive (ex – TI Group plc)	1992	22,134	638.36p	2001-2002
	1992	2,459	539.76p	2001-2002
	1993	82,635	612.95p	2001-2003
	1993	4,426	716.63p	2001-2003
	1994	86,073	846.74p	2001-2004
	1994	291,186	759.33p	2001-2004
	1995	99,848	765.42p	2001-2005
	1995	70,827	875.21p	2001-2005
	1996	185,921	1,058.18p	2001-2006
	1996	131,058	1,121.20p	2001-2006
	1997	454,977	1,097.82p	2001-2007
	1997	794,612	1,219.80p	2001-2007
	1998	762,142	1,026.66p	2001-2008
	1998	448,071	849.79p	2001-2008
	1999	643,620	943.31p	2002-2009
	1999	1,466,767	907.23p	2002-2009
	1999	543,984	1,103.92p	2002-2009
	2000	1,845,256	661.23p	2003-2010
	2000	1,840,451	626.16p	2003-2010
	2000	113,624	672.92p	2003-2010

29 Share premium account and reserves	Share premium account £m	Revaluation reserve £m	Merger reserves £m	Profit and loss account £m
Consolidated				
At 1 August 2000 – Smiths Industries plc	119.7	3.3		287.6
– TI Group plc	228.8			482.6
Merger difference			6.0	
Transfer of share premium	(228.8)		228.8	
Alignment of accounting policies – write-off of goodwill acquired before 1 August 1998				(477.5)
Merged reserves at 1 August 2000	119.7	3.3	234.8	292.7
Premium on allotments	26.4			(2.2)
Retained loss		(0.1)		(405.4)
Write-back of goodwill on actual and anticipated future disposals				470.3
Exchange rate changes (including tax on recognised gains)				(12.7)
At 31 July 2001	**146.1**	**3.2**	**234.8**	**342.7**
Company				
At 1 August 2000	119.7	0.6	180.5	231.2
Premium on allotments	26.4			(1.6)
Retained loss		(0.1)		(115.6)
Exchange rate changes				4.4
At 31 July 2001	**146.1**	**0.5**	**180.5**	**118.4**

The retained profit of the company represents a profit for the year of £23.2m less dividends payable of £138.9m.

During the year the company received £10.3m on the issue of shares in respect of the exercise of options awarded under various share option schemes. Employees paid £8.1m for the issue of these shares and the balance of £2.2m comprised contributions to the qualifying employee share ownership trust (QUEST) from undertakings within the company. The trust has been included within the company and consolidated financial statements.

2,624,134 shares at market values totalling £18.1m were taken up by shareholders as a scrip alternative to cash dividends.

Goodwill relating to acquisitions made before 1 August 1998 and written off to reserves amounted to £1,753.3m (2000 £2,223.6m).

30 Movements in shareholders' equity	2001 £m	2000 £m
Profit/(loss) for the year	**(206.0)**	324.0
Dividends	**(199.5)**	(165.6)
	(405.5)	158.4
Exchange variations	**(10.3)**	23.2
Taxation recognised on exchange gains:		
Current – UK		(2.7)
Deferred – US	**(2.4)**	(6.6)
Share issues	**26.2**	27.3
Write-back of goodwill on actual and anticipated future disposals	**470.3**	
Net increase in shareholders' funds	**78.3**	199.6
Shareholders' funds:		
At 1 August 2000	**787.4**	587.8
At 31 July 2001	**865.7**	787.4

31 Contingent liabilities	2001 £m	2000 £m
The company has guaranteed the 8.34% Senior Notes 2002 privately placed by a subsidiary	**69.9**	66.7

32 Analysis of merged company results

	Smiths Industries plc 4 months to 30 November 2000 £m	TI Group plc 4 months to 30 November 2000 £m	Alignment of accounting policies £m	Smiths Group plc 8 months to 31 July 2001 £m	Total £m
				Year ended 31 July 2001	
Continuing operations	497.1	544.1		2,357.1	3,398.3
Acquisitions	3.6			64.3	67.9
Discontinued businesses	9.9	513.6		968.5	1,492.0
Turnover	510.6	1,057.7		3,389.9	4,958.2
Continuing operations	75.6	71.0		369.4	516.0
Acquisitions	0.4			8.2	8.6
Discontinued businesses	0.7	56.8		66.2	123.7
Operating profit before goodwill amortisation and restructuring costs	76.7	127.8		443.8	648.3
Goodwill amortisation:					
Continuing operations	(6.1)	(10.0)	2.6	(17.5)	(31.0)
Acquisitions	(0.2)			(3.4)	(3.6)
Discontinued businesses		(8.0)	2.8	(8.9)	(14.1)
Restructuring costs:					
Continuing operations	(1.8)			(114.0)	(115.8)
Discontinued businesses		(9.0)		(8.7)	(17.7)
Operating profit	68.6	100.8	5.4	291.3	466.1
Share of profits of associated companies		1.0		2.0	3.0
Total group operating profit	68.6	101.8	5.4	293.3	469.1
Exceptional items – merger costs				(54.2)	(54.2)
– loss on disposal of businesses				(286.0)	(286.0)
– write-down of goodwill on anticipated future disposals				(125.0)	(125.0)
Profit before interest and tax	68.6	101.8	5.4	(171.9)	3.9
Net interest payable	(6.8)	(27.2)		(82.2)	(116.2)
Profit/(loss) before taxation	61.8	74.6	5.4	(254.1)	(112.3)
Taxation	(21.0)	(30.2)		(40.9)	(92.1)
Profit/(loss) after taxation	40.8	44.4	5.4	(295.0)	(204.4)
Minority interests	(0.4)			(1.2)	(1.6)
Profit/(loss) for the period	40.4	44.4	5.4	(296.2)	(206.0)
Dividends				(199.5)	(199.5)
Retained profit/(loss)	40.4	44.4	5.4	(495.7)	(405.5)

Analysis of the statement of total recognised gains and losses	Year ended 31 July 2001 £m	Year ended 31 July 2000 £m
Profit/(loss) for the year		
Smiths Industries plc to date of merger	40.4	177.0
TI Group plc to date of merger	44.4	120.7
Accounting policy adjustment	5.4	26.3
	90.2	324.0
Enlarged Smiths Group plc from date of merger	(296.2)	
	(206.0)	324.0
Exchange gains and losses		
Smiths Industries plc to date of merger	1.9	
TI Group plc to date of merger	(2.4)	
Enlarged Smiths Group plc from date of merger	(9.8)	23.2
Taxation recognised on exchange gains by Smiths Group plc from date of merger:		
Current – UK		(2.7)
Deferred – US	(2.4)	(6.6)
	(218.7)	337.9

32 Analysis of merged company results continued	Smiths Industries plc £m	TI Group plc £m	Alignment of accounting policies £m	Total £m
	Year ended 31 July 2000			
Continuing operations	1,436.4	1,625.1		3,061.5
Acquisitions				
Discontinued businesses	27.3	1,564.1		1,591.4
Turnover	1,463.7	3,189.2		4,652.9
Continuing operations	274.0	190.9		464.9
Acquisitions				
Discontinued businesses	1.9	151.7		153.6
Operating profit before goodwill amortisation and restructuring costs	275.9	342.6		618.5
Goodwill amortisation:				
Continuing operations	(10.3)	(28.0)	17.8	(20.5)
Acquisitions				
Discontinued businesses		(23.5)	8.5	(15.0)
Restructuring costs:				
Continuing operations		(10.6)		(10.6)
Discontinued businesses		(8.7)		(8.7)
Operating profit	265.6	271.8	26.3	563.7
Share of profits of associated companies		4.3		4.3
Total group operating profit	265.6	276.1	26.3	568.0
Exceptional items – merger costs				
– loss on disposal of businesses		(3.3)		(3.3)
– write-down of goodwill on anticipated future disposals				
Profit before interest and tax	265.6	272.8	26.3	564.7
Net interest payable	(9.6)	(71.1)		(80.7)
Profit before taxation	256.0	201.7	26.3	484.0
Taxation	(78.3)	(80.0)		(158.3)
Profit/(loss) after taxation	177.7	121.7	26.3	325.7
Minority interests	(0.7)	(1.0)		(1.7)
Profit/(loss) for the period	177.0	120.7	26.3	324.0
Dividends	(75.3)	(90.3)		(165.6)
Retained profit/(loss)	101.7	30.4	26.3	158.4

Smiths Group plc and TI Group plc merged on 4 December 2000. Under an arrangement approved by the Court on 30 November 2000, 233,604,697 Smiths Group plc ordinary shares of 25p each were issued in exchange for the ordinary share capital of TI Group plc, on the basis of 0.46 Smiths Group plc ordinary share for each TI Group plc ordinary share in issue. The closing mid-market price of one Smiths Group plc ordinary share at the date of the merger was 817.5p, valuing Smiths Group plc at £2.6bn and TI Group plc at £1.9bn, and the merged group at £4.5bn.

The net asset values of Smiths Group plc and TI Group plc as at the date of the merger were estimated at £530m and £800m respectively, before any adjustments resulting from a subsequent review and possible realignment of accounting policies.

The company has adopted merger accounting principles in consolidating the balance sheets of the merged groups of companies. Under this convention there is no requirement to revalue separately the assets and liabilities of each member of the enlarged group, and the only accounting policy realignment which proved to be necessary related to accounting periods. Smiths Group plc reported to 31 July in each year, and TI Group plc reported to 31 December. The merged group has therefore standardised on an accounting reference date of 31 July. The only adjustment to arise from this realignment was a write-off to reserves of previously capitalised goodwill acquired by TI Group plc during the period 1 January 1998 to 31 July 1998 at a total cost of £529.4m. The net book value of this goodwill as at 1 August 2000 amounted to £477.5m.

Movements on the combined reserves of the merged companies are given in the table in note 29.

>ACCOUNTING POLICIES

Accounting convention

The accounts have been prepared in accordance with the Companies Act 1985, as amended and with all applicable financial reporting and accounting standards under the historical cost convention modified to include the revaluation of certain properties.

FRS18 – Accounting Policies and applicable sections of FRS17 – Retirement Benefits were adopted during the year to 31 July 2001.

Basis of consolidation

The consolidated financial statements have been prepared under merger accounting principles to include the parent company and subsidiary undertakings of both Smiths Group plc and TI Group plc.

The results of subsidiaries acquired during the year are consolidated from the date of acquisition.

Up to 1 August 1998, goodwill arising on consolidation, representing the difference between the cost of acquisition of a subsidiary undertaking and the fair value of its net assets at the date of acquisition, was charged to reserves in the year of acquisition. Goodwill impairment on prospective disposals is recognised through the Profit and Loss Account.

Following the implementation of FRS10 – Goodwill and Intangible Assets, goodwill arising from acquisitions after 1 August 1998 is capitalised at cost, and amortised on a straight-line basis over an estimated useful economic life of up to 20 years.

Turnover

Turnover represents the invoiced amount of goods sold and services provided during the year, after the deduction of trade discounts and sales related taxes, and the value of work undertaken during the year on long-term contracts.

Research and development

Expenditure, other than that recoverable from third parties, is written off in the year in which it is incurred.

Fixed assets

Depreciation is provided at rates estimated to write off the relevant assets by equal annual amounts over their expected useful lives. In general, the rates used are: Freehold and long leasehold buildings – 2%, Short leasehold property – over the period of the lease, Plant, machinery etc. – 10% to 20%, Motor vehicles – 25%, Tools and other equipment – 10% to 33%.

Fixed assets held under finance leases are capitalised and depreciated in accordance with the company's depreciation policy. The capital element of future lease payments is included in creditors.

Payments made under operating leases are charged to the profit and loss account as incurred over the term of the lease.

Freehold properties

These financial statements include certain properties at 1974 valuation, less depreciation on the enhanced values calculated in accordance with the policy set out above. The directors have decided to invoke the transitional provisions of FRS15 – Tangible Fixed Assets, and do not intend to revalue these properties every year.

Leased properties

Where a leasehold property is vacant, or sub-let under terms such that the rental income is insufficient to meet all outgoings, provision is made for the anticipated future shortfall up to termination of the lease.

Stocks

Stocks and work in progress are valued at cost, including related production overheads, reduced to estimated net realisable value where appropriate. Profit is taken on long-term contracts by reference to the work completed. Provision for losses is made as soon as they are recognised.

Financial instruments

Financial assets are recognised in the balance sheet at the lower of cost and net realisable value. Discounts, premia and related costs of issue are charged or credited to the profit and loss account over the life of the asset or liability to which they relate.

The company uses derivative financial instruments to hedge its exposure to fluctuations in interest rates and foreign exchange rates.

Receipts and payments on interest rate instruments are recognised on an accruals basis over the life of the instrument.

Foreign currency assets and liabilities covered by forward contracts are translated at the contract rates of exchange. Other assets and liabilities in foreign currencies are translated at closing rates.

Foreign currencies

The profit and loss accounts of overseas subsidiaries are translated into sterling at average rates of exchange for the year.

Exchange adjustments arising from the retranslation of opening net assets in overseas subsidiaries and their results for the year at closing rates, and the translation of foreign currency borrowings to match overseas investments, are taken to the statement of total recognised gains and losses. All other exchange gains and losses are taken to the profit and loss account.

Taxation

Deferred tax is recognised in respect of timing differences that have originated but not reversed as at the balance sheet date, to the extent that it is considered probable that a liability or asset will crystallise in the foreseeable future. Timing differences are differences between the group's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been declared or an obligation is present to distribute past earnings. Deferred tax is not recognised on any fixed assets that have been revalued unless there is a binding agreement to sell the asset.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Post retirement benefits

The cost of providing pensions and post retirement healthcare for employees is charged in the profit and loss account over the working life of the employees taking into account the recommendation of qualified actuaries. Any funding surpluses or deficits that arise are amortised over the average working life of employees.

>STATEMENT OF VALUE ADDED

	2001 £m		2000 £m	
Turnover	**4,958.2**		4,652.9	
Deduct:				
Purchased materials and services	**2,755.3**		2,587.6	
Value added	**2,202.9**		2,065.3	
		%		%
Utilised as follows:				
Wages, pension contributions and employee benefits	**1,413.9**	**64.2**	1,315.5	63.7
Reorganisation costs	**133.5**	**6.1**	19.3	0.9
Merger costs	**54.2**	**2.5**		
Losses on actual/anticipated disposals	**411.0**	**18.6**		
Taxation	**92.1**	**4.2**	158.3	7.7
Net interest	**116.2**	**5.3**	80.7	3.9
Dividends	**199.5**	**9.0**	165.6	8.0
Goodwill amortisation	**48.7**	**2.2**	35.5	1.7
Depreciation	**139.3**	**6.3**	132.0	6.4
Retained profit	**(405.5)**	**(18.4)**	158.4	7.7
Value added	**2,202.9**	**100.0**	2,065.3	100.0

>FIVE YEAR REVIEW

	2001 £m	2000 £m	1999 £m	1998 £m	1997 £m
Turnover – continuing operations	**3,466.2**	3,061.5	2,814.0	2,225.1	2,014.5
– discontinued operations	**1,492.0**	1,591.4	957.3	912.0	868.2
	4,958.2	4,652.9	3,771.3	3,137.1	2,882.7
Operating profit – continuing operations	**524.6**	464.9	421.9	375.6	337.1
– discontinued operations	**126.7**	157.9	109.3	94.2	88.9
	651.3	622.8	531.2	469.8	426.0
Goodwill amortisation	**(48.7)**	(35.5)	(5.9)		
Operating profit (after goodwill amortisation)	**602.6**	587.3	525.3	469.8	426.0
Net interest	**(116.2)**	(80.7)	(46.7)	(22.6)	(12.8)
Profit before exceptional items	**486.4**	506.6	478.6	447.2	413.2
Exceptional items	**(598.7)**	(22.6)	(15.0)	3.7	(1.0)
Profit before taxation	**(112.3)**	484.0	463.6	450.9	412.2
Profit after taxation	**(204.4)**	325.7	316.8	305.7	281.2
Minority interests	**(1.6)**	(1.7)	(1.1)	(2.3)	(2.3)
Shareholders' equity	**865.7**	787.4	605.7	275.8	614.5
Represented by:					
Intangible fixed assets	**678.3**	851.4	380.5	0.0	0.0
Tangible fixed assets and investments	**957.2**	1,018.8	907.8	723.0	584.8
Net current assets	**350.0**	382.9	290.8	193.8	164.6
Net debt	**(1,119.8)**	(1,465.7)	(973.4)	(641.0)	(134.9)
Funds employed	**865.7**	787.4	605.7	275.8	614.5
Goodwill charged directly to reserves	**1,753.3**	2,223.6	2,223.6	2,222.3	1,576.0
Shareholder investment	**2,619.0**	3,011.0	2,829.3	2,498.1	2,190.5

	2001	2000	1999	1998	1997
Ratios					
Operating profit before goodwill amortisation: turnover (%)	**13.1**	13.4	14.1	15.0	14.8
Taxation before goodwill amortisation and exceptional items (%)	**29.2**	30.6	30.9	31.2	31.8
After tax return on average shareholder investment (%)	**12.5**	12.9	12.6	13.1	12.6
Cash-flow					
Cash-flow from operating activities	**701.0**	666.6	551.3	484.9	444.6
Less capital expenditure (net)	**(188.0)**	(168.2)	(135.1)	(102.2)	(105.8)
Operating cash after capital expenditure	**513.0**	498.4	416.2	382.7	338.8
Free cash-flow (before acquisitions and dividends, after capital expenditure)	**279.5**	336.5	223.7	215.7	201.0
Free cash-flow per share (p)	**50.6**	61.7	41.8	40.9	38.4
Earnings per share before goodwill amortisation and exceptional items (p)	**68.3**	68.6	62.7	58.4	53.8
Dividends					
Pence per share	**25.0**	23.80	21.65	19.65	17.85
Times covered before goodwill amortisation	**2.7**	2.5	2.4	2.4	2.4
Number of employees (000's)					
UK	**13.5**	15.1	15.4	15.6	10.9
Overseas	**24.2**	45.7	37.4	32.3	27.6
	37.7	60.8	52.8	47.9	38.5

>THE SENIOR MANAGEMENT OF SMITHS GROUP plc

Keith Butler-Wheelhouse*
Chief Executive

Anne Minto, OBE
Director, Human Resources

Russell Plumley
Director, Corporate Communications

Robin Taunt
Director, Corporate Development

David Lillycrop*
Director and General Counsel

Steve Aubrey
Director, Property

Guy Norris
Deputy Group Secretary

Clare Shepherd
Director of Legal Affairs

Steve Warren
Director, Retirement Benefits

Alan Thomson*
Financial Director

David Flowerday
Group Financial Controller

Peter Mason
Director, Corporate Finance

Michael Walls
Director, Internal Audit

*Executive Director

Aerospace

John Ferrie*
Group Managing Director

Brian Knight
Director and Group Controller

Ron Albrecht
President US Operations and Finance, Electronic Systems

George Donovan
VP, US Government Liaison

Robert F Ehr
President, Electronics Systems

Michael D Jones
Managing Director, UK Operations, Electronic Systems

John Legg
Managing Director, Customer Services

Bill Mawer
Director, Strategy and Marketing

Ron Nailer
Managing Director, Naval and Marine Systems

David Ramsay
Director, Human Resources

John Shepherd
Managing Director, Detection & Protection Systems

Michael Steel
Managing Director, Hamble Group

Paul Strothers
Managing Director, Actuation Systems

Peter Wright
President, Components

Sealing Solutions

John Langston*
Group Managing Director

Chris Surch
Director and Group Controller

Joe Abbruzzi
President, Polymer Sealing Solutions NA

Nick Anderson
President, John Crane Latin America

Roger Bishop
Managing Director, John Crane MEAA

John F Cousins, OBE
Chief Executive, John Crane-Lips

Mike Mansell
Chief Executive, John Crane EAA

Robin Thompson
Director, Strategic Development

Bob Wasson
President, John Crane Americas

Udo Wendland
Managing Director, Polymer Sealing Solutions EAA

Medical

Lawrence Kinet*
Group Managing Director

Donald Broad
Director and Group Controller

Tony Beran
President, RSP Inc.

Pennie Boyko
Director, Human Resources

Howard Donnelly
President, Level 1 Inc

Chris Hutchison
Managing Director, Graseby Medical

Martin Jamieson
Managing Director, Portex Ltd

Frank Katarow
President, BCI Inc

John McConachie
President, National and Corporate Sales

Jim Smith
Managing Director, Europe and Asia/Pacific

Jim Stitt
President, Deltec Inc

Jeff Spielman
President, Portex Inc

Edward Yoxen
VP, Business Development

Industrial

Einar Lindh*
Group Managing Director

Graham Hardcastle
Director and Group Controller

Roger Ellis
Director, Business Development

Martin Jones
Director, Technology and Innovation

Stephen Phipson
Managing Director, Interconnect

Kevin Sargeant
Managing Director, Ventilation Systems

Christine Scholes
Director, HR and Legal

Tedd Smith
President, Flexible Technologies Inc

David Spencer
Managing Director, Interconnect Systems

>ANALYSIS OF ORDINARY SHAREHOLDERS
13 September 2001

Class of shareholder	No. of holders	No. of shares	% of total listed shares
Insurance companies	8	7,557,278	1.36
Pension funds	11	199,404	0.04
Banks	25	570,083	0.10
Nominees	10,403	493,874,477	88.85
Limited companies and other corporate bodies	2,341	26,748,450	4.81
Individuals	27,682	26,883,544	4.84
Total	**40,470**	**555,833,236**	**100.00**

>FINANCIAL CALENDAR

2001

September
26 Preliminary announcement of results for 2000-2001

October
03 Ordinary shares final dividend ex-dividend date
05 Ordinary shares final dividend record date

November
13 Annual General Meeting
16 Ordinary shares final dividend payment date

2002

March
13 provisional 2001-2002 interim results announced
20 provisional Ordinary shares interim dividend ex-dividend date
22 provisional Ordinary shares interim dividend record date

April
19 provisional Ordinary shares interim dividend payment date

July
31 Smiths Group financial year-end

September
25 provisional Preliminary announcement of results for 2001-2002

October
15 provisional Ordinary shares final dividend ex-dividend date
18 provisional Ordinary shares final dividend record date

November
12 provisional Annual General Meeting
15 provisional Ordinary shares final dividend payment date

Registered Office
Smiths Group plc
765 Finchley Road
London NW11 8DS
Incorporated in England No 137013
Tel: +44 (0) 20 8458 3232
Fax: +44 (0) 20 8458 4380
E-mail: plc@smiths-group.com
www.smiths-group.com

Registrar
Lloyds TSB Registrars
The Causeway
Worthing
West Sussex BN99 6DA
Tel: 0870 600 3970 (UK)
Tel: +44 (0) 1903 502541
www.lloydstsb-registrars.co.uk
www.shareview.co.uk

Auditors
PricewaterhouseCoopers

>NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the eighty-seventh Annual General Meeting of Smiths Group plc will be held at the offices of J P Morgan plc, 10 Aldermanbury, London EC2V 7RF on Tuesday 13 November 2001 at 12.00 noon for the following purposes:

Ordinary business

1. To adopt the Reports of the Directors and the auditors and the audited accounts for the year ended 31 July 2001.

2. To declare a final dividend on the ordinary shares.

To re-appoint the following directors:

3. Mr E Lindh
4. Mr A M Thomson
5. Sir Nigel Broomfield
6. Sir Colin Chandler
7. Mr J M Hignett
8. Mr J Langston
9. Mr D P Lillycrop

Notes

Messrs Lindh and Thomson will retire by rotation in accordance with Articles 73 and 74.

Sir Nigel Broomfield, Sir Colin Chandler and Messrs Hignett, Langston and Lillycrop will retire following their appointments during the year.

Sir Nigel Broomfield, Sir Colin Chandler and Mr Hignett are all members of the Audit and the Nominations and Remuneration Committees.

10. To re-appoint PricewaterhouseCoopers as auditors to the company.

11. To authorise the directors to determine the remuneration of the auditors.

Special business

12. To consider and, if thought fit, pass the following ordinary resolution:

That, in accordance with Article 6 of the Articles of Association of the company, the directors be and are hereby authorised to allot relevant securities having a nominal value not exceeding £46,324,123 in aggregate (such authority to expire on the day falling five years after the passing of this resolution) and that all previous authorities under section 80 of the Companies Act 1985 are hereby revoked and shall henceforth cease to have effect.

13. To consider and, if thought fit, pass the following special resolution:

That, in accordance with Article 7 of the Articles of Association of the company, the directors be and are hereby authorised to allot equity securities for cash, and for the purposes described in paragraph (b) of Article 7, the nominal amount to which this power is limited shall be £6,948,618 (such authority to expire on the day falling five years after the passing of this resolution), and that all previous authorities under section 95 of the Companies Act 1985 are hereby revoked and shall henceforth cease to have effect.

14. To consider and, if thought fit, pass the following special resolution:

That the company is hereby generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of ordinary shares of 25p each in the capital of the company ('ordinary shares') provided that:

(a) the maximum number of ordinary shares hereby authorised to be purchased is 55,588,948;

(b) the minimum price which may be paid for an ordinary share is 25p per ordinary share;

(c) the maximum price which may be paid for an ordinary share is an amount equal to 105% of the average middle market quotations for an ordinary share, as derived from the London Stock Exchange Daily Official List, for the five business days immediately preceding the day on which the ordinary share is purchased;

(d) the authority hereby conferred shall expire at the conclusion of the next general meeting of the company, unless such authority is renewed at such time; and

(e) the company may make a contract to purchase ordinary shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiry of such authority and may make a purchase in pursuance of any such contract.

15. To consider and, if thought fit, pass the following ordinary resolution:

That the amendments to the rules of the Smiths Industries 1995 Executive Share Option Scheme (the 'Scheme') as explained in the letter to shareholders from the Chairman dated 12 October 2001 (and the Appendix to that letter) and as shown in the amended rules in the form produced to the meeting and initialled by the Chairman for the purposes of identification be and they are hereby approved and adopted (subject to any amendments required by the Inland Revenue in order to maintain approval of Section A of the Scheme under Schedule 9 to the Income and Corporation Taxes Act 1988).

By Order of the Board
David P Lillycrop
Director and Secretary

12 October 2001
Registered Office:
765 Finchley Road, London NW11 8DS

Notes

1. A member entitled to attend and vote at the Annual General Meeting may appoint a proxy or proxies to attend and, on a poll, vote on his/her behalf. A proxy need not be a member. Proxy Forms must be deposited at Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6AX, not later than 48 hours before the Annual General Meeting to be effective. In the case of a corporation, the appointment of a proxy must be made either under its common seal or by a duly authorised officer or agent.

2. In the case of joint holders, the vote of the first named on the register will be accepted to the exclusion of other joint holders.

3. Only those shareholders registered in the register of members of the company at 6 pm on 11 November 2001 shall be entitled to attend or vote at the Annual General Meeting in respect of the number of shares registered in their respective names at that time. Changes to entries on the register after 6 pm on 11 November 2001 shall be disregarded in determining the rights of any person to attend or vote at the Annual General Meeting.

4. Copies of the following documents are available for inspection at the registered office and at the offices of Allen & Overy, One New Change, London EC4M 9QQ during normal business hours from the date of this notice and at the place of the meeting from 11.45 am until its conclusion:
(i) Directors' service contracts
(ii) Latest drafts of the proposed rules of the Smiths Industries 1995 Executive Share Option Scheme.

5. Subject to the final dividend being approved at the Annual General Meeting, dividend warrants will be payable on 16 November 2001 to the ordinary shareholders on the register at the close of business on 5 October 2001.

6. The market value of an ordinary share on 31 March 1982 for the purposes of capital gains tax was:

Ordinary shares 91.25p
(taking into account the sub-division of 50p shares into 25p shares on 14 January 1985).

7. Although copies of the Annual Report are distributed to shareholders and option-holders, only shareholders, or their proxies, are entitled to attend and vote at the Annual General Meeting.

8. The company is not a close company.

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Photograph of Eurofighter Typhoon courtesy of Eurofighter GmbH. Photograph of C-130 courtesy of US Air Force.

www.smiths-group.com

Smiths Group plc
765 Finchley Road
London NW11 8DS
Tel: +44 (0) 20 8458 3232
Fax: +44 (0) 20 8458 4380
E-mail: plc@smiths-group.com